TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 602

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, PETITIONER

vs.

OBISPO OIL CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED DECEMBER 28, 1936

CERTIORARI GRANTED FEBRUARY 8, 1937

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INDEX

	Original	Print
Record from D. C. U. S., Southern California	1	1
Names and addresses of Solicitors [omitted in printing]	1	1
Citation and service [omitted in printing]	2	1
Amended complaint	4	1
Answer to amended complaint	14	6
Stipulation waving jury	22	10
Motion for judgment	23	10
Memorandum of points and authorities	24	11
Memorandum of conclusions and order for judgment	25	12
Findings of fact and conclusions of law	26	12
Judgment on findings	44	23
Certificate of probable cause	45	24
Bill of exceptions	46	24
Stipulation re approval of bill of exceptions	47	25
Order settling bill of exceptions	48	25
Petition for appeal	49	26
Assignments of error	50	26
Order allowing appeal	52	27
Bond on appeal [omitted in printing]	53	27
Stipulation re docketing of appeal, etc	55	27
Praecipe for transcription of record	56	28
Clerk's certificate [omitted in printing]	58	29

	Original	Print
Supplemental record from D. C. U. S., Southern California	60	29
Names and addresses of attorneys [omitted in printing]	61	29
Citation and service [omitted in printing]	62	29
Petition for cross-appeal	63	29
Assignments of error on cross-appeal	65	30
Order allowing cross-appeal	67	31
Stipulation re one transcript on appeals	68	31
Praecipe for transcript of record	70	32
Clerk's certificate [omitted in printing]	71	33
Proceedings in U. S. C. C. A., Ninth Circuit	72	34
Caption	72	34
Order of submission	73	34
Order directing filing of opinions and decree	74	34
Opinion, Haney, J.	75	35
Dissenting opinion, Wilbur, J.	82	39
Judgment	83	40
Clerk's certificate	84	41
Order allowing certiorari	86	42

1 [Names and addresses of solicitors omitted in printing.]

2–3 [Citation in usual form showing service on Peirson M. Hall, filed Dec. 24, 1935, omitted in printing.]

4 In United States District Court for the Southern District of California, Central Division

At Law No. 3334–J

OBISPO OIL COMPANY, A CORPORATION, PLAINTIFF

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, DEFENDANT

Amended complaint

Filed Oct. 21, 1933

Now comes the Plaintiff, Obispo Oil Company, a corporation, and through its attorneys complains of the defendant, Galen H. Welch, and as and for a cause of action against said defendant alleges:

I

That the plaintiff, Obispo Oil Company, is and was at all times hereinafter mentioned, a corporation organized under the laws of the State of California, and having its principal office and place of business at San Luis Obispo, California.

II

That the jurisdiction of this Court is dependent upon a Federal question in that the cause arises under the laws of the United
5 States of America pertaining to Internal Revenue, to-wit, the Revenue Act of 1918 and prior and subsequent Acts.

III

That the defendant, Galen H. Welch, was during the period from April 6, 1926, to June 30, 1933, inclusive, Collector of Internal Revenue for the Sixth Collection District of California, duly commissioned and acting pursuant to the laws of the United States, and resides and has his office in the City of Los Angeles in said State of California.

IV

That this action is brought against the defendant as an officer acting under and by virtue of the Revenue Acts of 1918 and 1926 on account of acts done under color of his office and of the Revenue Laws of the United States as will hereinafter more fully appear.

V

That the plaintiff duly filed with the proper officer designated by statute its corporate income and profits tax returns for the calendar year 1920, as required by law and within the period prescribed by law, that is, on, to-wit, March 15 and June 13, 1921, and duly paid the tax shown to be due thereon, namely, $426.65. Thereafter, during the year 1923, additional tax for the calendar year 1920 in the amount of $2,864.40 was assessed against and paid by the plaintiff. Neither of the amounts above mentioned however, are here in issue.

VI

During June, 1926, Commissioner of Internal Revenue
6 erroneously and illegally assessed additional corporate income and profits taxes for the calendar year 1920 against the plaintiff herein in the amount of $264,017.74, plus interest in the amount of $2,144.69 and demanded payment thereof from plaintiff, and threatened to enforce payment of said tax by distraint and sale of plaintiff's property.

VII

Plaintiff objected to the assessment, collection and payment of said additional tax for the calendar year 1920 for the reason that the assessment, collection and payment of said tax and interest was erroneous, illegal, and in excess of that due from the plaintiff for said calendar year. The reasons therefor and the facts upon which plaintiff's objections and this complaint are based are as follows:

(1) The Commissioner of Internal Revenue erroneously added to the plaintiff's taxable income for the calendar year 1920 certain impounded funds released to the plaintiff during the year 1920. These funds consisted of moneys collected during the period from 1914 through 1919 by a receiver appointed by the United States District Court pending the outcome of certain litigation then being prosecuted between this plaintiff and the United States. The receiver appointed by the Court was at all times in possession and control of the entire properties of the plaintiff. On the termination of the litigation, during the year 1920, the funds accumulated by the receiver were turned over to the plaintiff.

7 The funds so collected by the receiver during the years 1914 to 1919 were taxable income to the recipient when actually collected and received by the receiver during those said years. Neither said funds nor any part thereof were taxable income to the plaintiff in 1920 on release thereof by said receiver.

(2) In the alternative, assuming but not conceding that the funds released by the receiver to the plaintiff during the year 1920 constituted taxable income to the plaintiff for said year, the Commissioner of Internal Revenue erroneously determined the income of

the plaintiff subject to tax for said year 1920 in the following particulars:

(a) Said impounded funds consisted largely of United States Government bonds in which during said period the receiver had invested the funds collected. The actual market value of said bonds at the date they were released and turned over to the plaintiff during the year 1920 was $47,822.62 less than the original cost thereof when purchased by said receiver. The Commissioner of Internal Revenue erroneously and illegally included these bonds in plaintiff's taxable income for the calendar year 1920 at original cost to the receiver instead of their fair market value at date they were turned over to the plaintiff. Even though the impounded funds turned over to the plaintiff during the year 1920 constituted income of plaintiff for said year, nevertheless the income of plaintiff for that year as determined by the Commissioner of Internal Revenue should be reduced in the amount of $47,822.62, made up as follows:

8 *Schedule of bonds released as impounded funds and market value at date of release December 6, 1920*

Bonds Released and on Hand—12-31-20	Face Value	Market	Market Value	Cost per Books
1st—3½% U. S. Bonds	$100,000.00	90	$90,000.00	$100,000.00
3rd—4½% " " "	269,000.00	88	254,320.00	277,820.75
5th—4¼% " " "	523,000.00	96½	499,465.00	513,786.87
			$843,785.00	$891,607.62
Total Market Value				843,785.00
Difference between market value at date of release and cost over books				$47,822.62

(b) That on or about the 23rd day of December, 1913, the plaintiff discovered a new deep oil zone underlying its properties; that said zone at the time of acquisition of said properties and on March 1, 1913, was unknown; that the discovery of said zone was due to the efforts of plaintiff; that the value of the oil content of said deep zone at date of discovery and thereafter was greatly disproportionate to the cost or March 1, 1913 value of said oil properties.

That as of March 10, 1914, the date upon which the United States instituted its suit to divest the plaintiff of its title in and to its forty acre tract, the fair market value of the oil and gas content of said forty acre tract was $1,363,780.00. That the estimated recoverable oil content in said forty acres on that date was 4,998,944 barrels; that the value per barrel of said oil on March 10, 1914 in the said forty acre tract was $.27281.

9 That under the provisions of the Revenue Act of 1918 which governs the determination of taxable income and the amount of tax for the calendar year 1920, the plaintiff was entitled to a deduction for depletion on a unit basis of $.27281 per barrel.

That assuming said impounded funds collected by the receiver from March 10, 1914, through the calendar year 1919 were taxable

income to the plaintiff during the year 1920, then the plaintiff was entitled to a deduction for depletion at the rates and in the amounts provided by the Revenue Act of 1918; that is, as follows:

Depletion on 2,372,881 barrels representing production from March 10, 1914, to December 31, 1920, at $.27281	$647,345.67

Commissioner of Internal Revenue, although charging the entire amount of said impounded funds as income to the plaintiff during the year 1920, erroneously and illegally allowed as a deduction for depletion upon said funds for said year, the rates prevailing and allowable in the years when said oil was actually extracted instead of the basis provided by the Revenue Act of 1918 as depletion actually sustained and as a result thereof allowed the plaintiff as depletion during the year 1920 but $152,571.98, thereby illegally and erroneously denying to the plaintiff a deduction in determining taxable income for the calendar year 1920 of $494,773.69. And the plaintiff is entitled to have its income for the year 1920 reduced by said amount in determining the income subject to tax.

(c) That the Commissioner of Internal Revenue, in determining the taxable net income for the taxable year 1920, erroneously included in the income of the plaintiff, a net amount of $235,945.96, representing proceeds of production prior to March 11, 1914, and interest accrued thereon through December 31, 1919, on the theory that said amounts were impounded with the Receiver and released to the plaintiff during the taxable year 1920. That said proceeds and the interest thereon were never impounded in the hands of the court receiver, but represented income realized to and accrued by the plaintiff during the taxable years 1914 to 1919 inclusive, or in the alternative, were not realized to and accrued by the plaintiff until February 1921.

VIII

The Commissioner of Internal Revenue properly determined the profits tax rate of this taxpayer for the calendar year 1920 as provided by Sections 327 and 328 at 9.67% of plaintiff's income due to the abnormality resulting from the inclusion in plaintiff's income for that year of said impounded funds.

IX

That despite the facts set forth in Paragraph VII above, the defendant exacted from the plaintiff and the plaintiff paid the defendant under protest, compulsion, duress, and coercion, additional income and profits taxes as set forth above for the calendar year 1920 on the date and in the amounts set forth below:

Date	Tax	Interest	Total
July 23, 1926	$264,017.74	$2,144.69	$266,162.43

11

X

Thereafter, on to-wit, the sixth day of December 1927, the plaintiff in the manner provided by law filed with the defendant, the Collector of Internal Revenue for the Sixth Collection District of California, as the agent for the Commissioner of Internal Revenue, its claim for the refund of said tax in the amount of $264,017.17, together with interest in the amount of $2,144.69 paid to the defendant as aforesaid. That said claim for refund sets forth fully, as specified in Paragraph VII hereof, the reasons upon which said claim for refund is predicated.

XI

On or about February 14, 1928, the Commissioner of Internal Revenue rejected in its entirety the plaintiff's said claim for refund.

XII

That in case there is eliminated from plaintiff's income for the year 1920 said impounded funds, the application of Sections 327 and 328 of the Revenue Act of 1918 in the determination of plaintiff's profits tax rate for the year 1920 will become unnecessary. In case plaintiff's income for the calendar year 1920 is reduced only by the additional depletion and by the over-statement due to the erroneous valuation of the bonds, all of which is set forth in Paragraph VII above, then the income of the plaintiff for the calendar year 1920 will nevertheless be abnormal and disproportionate to the income of similar taxpayers engaged in the same line of business for that

12 year. The profits tax rate heretofore employed by the Commissioner of Internal Revenue of 9.67% of plaintiff's net income should, therefore, be employed for the year 1920, assuming only said two adjustments above referred to are made.

XIII

That the defendant erroneously and unlawfully collected from the plaintiff and is erroneously and unlawfully withholding from the plaintiff and is indebted to said plaintiff in the sum of $266,162.48, with interest from July 23, 1926, at 6% representing amounts illegally exacted from the plaintiff on account of additional income and profits taxes for the year 1920. That although often demanded the defendant has not nor has anyone for him repaid or refunded said sum or sums or any part thereof, and said claim of said plaintiff herein is the sole property of the plaintiff and has not been sold, assigned, or transferred to any person or individual.

Wherefore, the plaintiff prays for judgment against the defendant, Galen H. Welch, in the amount of $266,162.43, together with interest at 6% from July 23, 1926, together with plaintiff's costs of suit.

OBISPO OIL COMPANY,
By J. F. BARNEBERG,
J. F. BARNEBERG, *President.*
JOSEPH D. PEELER,
MELVIN D. WILSON,
Attorneys for Plaintiff.

13 [*Duly sworn to by J. F. Barneberg, jurat omitted in printing.*]

[File endorsement omitted.]

14 In United States District Court

Answer to amended complaint

Filed Oct. 21, 1933

Comes now the above-named Defendant, Galen H. Welch, by and through his attorneys, Peirson M. Hall, United States Attorney for the Southern District of California, Alva C. Baird, Assistant United States Attorney for said District, and in answer to Plaintiff's Amended Complaint on file herein, admits, denies, and alleges as follows:

I

Admits the allegations of paragraph I of plaintiff's Amended Complaint.

II

Admits the allegations of paragraph II of plaintiff's Amended Complaint.

III

Admits the allegations of paragraph III of plaintiff's Amended Complaint.

IV

Admits the allegations of paragraph IV of plaintiff's Amended Complaint.

V

Admits the allegations of paragraph V of Plaintiff's Amended Complaint.

VI

Denies the allegations of paragraph VI of said Amended
15 Complaint except that it is admitted that the Commissioner of Internal Revenue during June 1926 duly assessed additional

corporate income and profits taxes for the calendar year 1920 against the plaintiff in the amount of $264,017.74, plus interest in the amount of $2,144.69.

VII

It is admitted that the Commissioner of Internal Revenue added to the plaintiff's taxable income for the calendar year 1920 certain impounded funds released to the plaintiff during the last-named year; and that these funds consisted of monies collected during the period from 1914 to 1919, inclusive, and for the portion of the year 1920 during which certain properties of the plaintiff operated under a Federal Receiver appointed by the United States District Court, pending the outcome of certain litigation then being prosecuted between this plaintiff and the United States. The Defendant specifically denies that the Receiver appointed by the Court was at any time in possession and control of the entire properties of the plaintiff. It is admitted that on the termination of the litigation, certain funds accumulated by the Receiver, were turned over to the plaintiff during the year 1920.

Defendant denies that the funds so collected by the Receiver during the years 1914 to 1919 were taxable income to the plaintiff and/or the recipient when actually collected and received by the Receiver during said years and specifically denies the allegation that said funds or any part thereof were not taxable income to the plaintiff in 1920 on release thereof by said Receiver.

16 For answer to paragraph (2) (a) of paragraph VII of plaintiff's amended complaint, defendant admits that the Commissioner of Internal Revenue erroneously included the bonds therein referred to, in plaintiff's taxable income for the year 1920 at the original cost to said Receiver, instead of their fair market value at the date they were turned over to the plaintiff. Defendant denies, however, that the fair market value of said bonds at the date they were released and turned over to the plaintiff during the year 1920, was $47,822.62 less than the original cost thereof when purchased by said Receiver, but admits that the fair market value of said bonds on said date was $47,461.37 less than the original cost thereof. All other allegations of said subdivision (2) (a) of paragraph VII are denied.

In answer to sub-paragraph (2) (b) of paragraph VII of plaintiff's amended complaint, defendant admits that on or about the 23rd day of December, 1913, plaintiff discovered a new deep oil zone underlying its properties; that said zone at the time of acquisition of said properties and on March 1, 1913, was unknown. All other allegations of said subdivision (2) (b) of paragraph VII of plaintiff's amended complaint are denied, except that it is admitted that the Commissioner of Internal Revenue allowed as a deduction for depletion upon the impounded funds released to the plaintiff during the year 1920, the depletion rates prevailing and allowable in the

years when said oil was actually extracted and actually al-
17 lowed the plaintiff as a deduction for depletion for the year 1920 in the amount of $152,571.98.

The defendant herein, Galen H. Welch, former Collector of United States Internal Revenue for the Sixth Collection District of California, specifically alleges that the allowance of a depletion deduction of $152,571.98 to the plaintiff for the calendar year 1920, or any other amount, was in error and alleges that the plaintiff was entitled to no depletion allowance or deduction for said taxable year 1920.

For answer to sub-paragraph (2) (c) of paragraph VII of said amended complaint, it is admitted that in determining the taxable net income for the taxable year 1920, the Commissioner of Internal Revenue included in the income of the plaintiff a net amount of $235,945.96, which consisted of a principal sum of $197,684.16, representing net proceeds of production prior to March 11, 1914, and taxable interest in the amount of $38,261.80 accrued thereon through December 31, 1919. It is admittd that said proceeds and interest thereon were never impounded in the hands of the Receiver appointed by the Court. All other allegations of said sub-paragraph (2) (c) are denied.

The defendant denies that the plaintiff herein has heretofore made any claim or contention that said $235,945.96, or any part thereof, was not impounded by the Receiver and released by it to the plaintiff during the taxable year 1920, and alleges that the contention now advanced in reference thereto in said sub-paragraph
18 (2) (c) of paragraph VII of said amended complaint, was not included in the claim for refund upon which this suit is based and that by reason thereof the plaintiff is now barred from raising any issue in reference thereto in this proceeding.

Defendant alleges that said sum of $235,945.96 constituted a pledgee account; that said funds were to be held in said account pending the outcome of the litigation between the plaintiff herein and the United States of America; that said litigation was finally terminated and settled during the year 1920; and that said amount of $235,945.96 was actually or constructively received by the plaintiff during said taxable year 1920 and constituted taxable income for said year.

VIII

The defendant admits that the Commissioner of Internal Revenue computed the profits tax of the plaintiff herein for the calendar year 1920, under the provisions of Sections 327 and 328 of the Revenue Act of 1918, but alleges that the rate determined under these provisions is immaterial to this proceeding and for lack of knowledge or information upon which to form a belief, denies that said rate was 9.67%, as alleged in plaintiff's amended complaint. The profits tax determined and assessed by the Commissioner of Internal Revenue for the year 1920 was $142,765.73.

IX

Defendant admits that on or about July 23, 1926, plaintiff paid additional income and profits tax for the taxable year 1920 in the aggregate amount of $266,162.43.

19

X

Defendant admits that on to-wit, the 6th day of December, 1927, the plaintiff filed with the defendant, the Collector of Internal Revenue for the Sixth Collection District of California, a claim for refund of income and profits taxes in the amount of $264,017.17, together with interest in the amount of $2,144.69. Defendant specifically denies that the claim for refund includes all of the reasons herein advanced in this amended complaint for the recovery of the above-named amounts, and alleges that said amended complaint injects issues into this proceeding not heretofore presented for the consideration of the Commissioner of Internal Revenue.

XI

Admits the allegations contained in paragraph XI of plaintiff's amended complaint.

XII

The allegations of paragraph XII are denied and defendant alleges that the Court is without jurisdiction to disturb any finding or determination made by the Commissioner of Internal Revenue as to the profits tax due from the plaintiff for said taxable year 1920.

XIII

Defendant denies that he erroneously or unlawfully collected from the plaintiff or that he was erroneously or unlawfully withholding from the plaintiff or is otherwise indebted to the plaintiff in the sum of $266,162.43 or any other amount or at all. Defendant admits no part of said sum has been repaid to the plaintiff, but alleges that all of the taxes paid by the plaintiff for the taxable years 1914 to 1919 have been heretofore refunded and accepted by the plaintiff. Further collection thereof is now barred by the statute of limitations. For lack of knowledge or information upon which to form a belief, defendant denies the remaining allegations of said paragraph XIII.

20

The defendant affirmatively alleges that the Commissioner of Internal Revenue erroneously allowed as a deduction the amount of $40,683.00, which amount was paid or accrued in connection with the litigation between the United States of America and G. W. McCutcheon, Obispo Oil Company, et al., and which constituted a capital expenditure.

Wherefore defendant prays that plaintiff take nothing by its complaint and that defendant be allowed his costs of suit herein expended as provided by law.

Peirson M. Hall,
PEIRSON M. HALL,
United States Attorney,
Ignatius F. Parker,
IGNATIUS F. PARKER,
Assistant U. S. Attorney,
Alva C. Baird,
ALVA C. BAIRD,
Assistant U. S. Attorney,
Counsel for Defendant.

21 [*Duly sworn to by Alva C. Baird, jurat omitted in printing.*]

[File endorsement omitted.]

22 In United States District Court

Stipulation waiving jury

Filed Dec. 27, 1928

We, the attorneys for the respective parties hereby waive the trial to the jury of this cause, and agree to submit the same to the Court without the intervention of a jury.

Dated: December 17, 1928.

MILLER, CHEVALIER & LATHAM,
By MELVIN D. WILSON,
Attorneys for Plaintiff.

Dated: December —, 1928.

UNITED STATES ATTORNEY,
By EMMETT E. DOHERTY,
Assistant United States Attorney,
Attorneys for Defendant.

[File endorsement omitted.]

23 In United States District Court

Motion for judgment

Filed Nov. 14, 1933

Now on this 10th day of November, 1933, comes Galen H. Welch, defendant in the above-entitled cause, by his attorneys, Peirson M. Hall, United States Attorney for the Southern District of California, Alva C. Baird, Assistant United States Attorney for said District, and Eugene Harpole, Special Attorney, Bureau of Internal Revenue,

and moves for judgment against the plaintiff and in favor of the defendant, and for his costs herein expended, upon the following grounds and for the following reasons:

I

By reason of the pleadings and the record upon which the case is submitted, the plaintiff is not as a matter of law entitled to recover the whole or any part of the sum sued for herein.

II

That this Court has no jurisdiction of the subject matter of this action, the tax sought to be recovered having been assessed under the special assessment provisions of Sections 327 and 328 of the Revenue Acts of 1918 and 1921 (40 Stat. 1092, 1093).

Dated: This 10th day of November, 1933.

Peirson M. Hall,
PEIRSON M. HALL,
U. S. Attorney, E. H.,
Alva C. Baird,
ALVA C. BAIRD,
Asst. U. S. Attorney, E. H.,
Eugene Harpole,
EUGENE HARPOLE,
Special Attorney, Bureau of Internal Revenue,
Attorneys for Defendant.

24 *Memorandum of points and authorities*

I. The taxes involved in this action were assessed under the "special assessment" provisions of Sections 327 and 328 of the Revenue Acts of 1918 and 1921. (40 Stat. 1092, 1093.)

II. The grant of special assessment and the ascertainment of the rate or ratio of tax to be applied to the net income of the taxpayer are indissolubly connected by the terms of the statute. The exercise of the discretion on both aspects is committed to the Commissioner and to the Board of Tax Appeals upon review of his action. That discretion cannot be reviewed by the Courts, nor exercised by them in place of the administrative officer designated by law. It is beyond the power of a Court to usurp the Commissioner's function of finding that special assessment should be accorded, and equally so to substitute its discretion for his as to the factors to be used in computing the tax. The taxpayer's net income is an essential factor in the problem. Heiner v. Diamond Alkali Company, 53 S. Ct. 413, reversing C. C. A. 3rd, 60 Fed. (2d) 505, which affirmed the District Court, 39 Fed. (2d) 645. See also, Williamsport Wire Rope Co. v. U. S., 48 S. Ct. 587, 6 A. F. T. R. 7797, affirming U. S. Court of Claims, 63 Ct. of Cls., 463; Brown's "Shamrock" Linens, Ltd., v.

Bowers, C. C. A. 2nd, 48 F. (2d) 103, affirming Dist. Court, 41 Fed. (2d) 862; certiorari denied 282 U. S. 865, 51 S. Ct. 657; Blair v. Oesterline Machine Co., 275 U. S. 220.

(Endorsed:) Received copy of the within Motion for Judgment this 10th day of Nov. 1933. Miller, Chevalier, Peeler & Wilson, by Ralph E. Smith, Attorney for Plaintiff.

[File endorsement omitted.]

25 In United States District Court

Memorandum of conclusions and order for judgment

Filed May 21, 1934

This cause has been submitted on the record of the evidence presented at the trial upon which a judgment was rendered and subsequently vacated; together with a stipulation as to certain facts. A motion was earlier presented for judgment in favor of the defendant, based upon the ground that the court has no jurisdiction to adjudicate the issues involved.

I will state my conclusions, only, without entering upon any discussion of the facts, or decisions cited by the parties.

I conclude:

That the court has jurisdiction.

That the amount of money received by the plaintiff from the Receiver in 1920 did not constitute a gift.

That depletion allowances should be made only as of the time after plaintiff received its lease from the Government, to-wit: after April 20, 1920; and that any computation of such depletion allowances should be made under the Revenue Act of 1918.

The parties can together prepare the judgment to be entered, to which exception will be noted in favor of the plaintiff, and also in favor of the defendant on the adverse ruling on the question of jurisdiction.

Dated May 21, 1934.

WM. P. JAMES,
U. S. District Judge.

[File endorsement omitted.]

26 In United States District Court

Findings of fact and conclusions of law

Filed Sept. 23, 1935

The Court herein entered a judgment in this cause, on June 17, 1931, in favor of the Plaintiff, in the amounts prayed for in the Complaint. The decision was reported in 48 Fed. (2d) 872. The

Defendant took an appeal to the United States Circuit Court of Appeals for the Ninth Circuit, and, while said appeal was pending, the above entitled proceeding was remanded to this Court as a result of a joint motion filed by Counsel for the respective parties in the United States Circuit Court of Appeals for the Ninth Circuit. The basis of the motion was that

"Counsel for the respective parties are of the opinion that the decision of this Court and of the United States Supreme Court in the case of North American Oil Consolidated v. Burnet, 286 U. S. 417, are controlling as to the issue upon which the instant case was decided. There are, however, issues in controversy which were not adjudicated or determined by the District Court in the first instance."

After the cause was remanded to this Court, the Plaintiff filed an Amended Complaint and the Defendant filed an Answer to the said Amended Complaint.

The above case came on regularly for trial on the 21st day of October, 1933, before the Court, sitting without a Jury, a trial by Jury having been waived by written stipulation of the parties hereto; Plaintiff appearing by Joseph D. Peeler, Esq., and Melvin D. Wilson, Esq., of Miller, Chevalier, Peeler & Wilson, its Attorneys,
27 and the Defendant appearing by Peirson M. Hall, Esq., United States Attorney for the Southern District of California, Ignatius F. Parker, Esq., and Alva C. Baird, Esq., Assistant United States Attorneys for the said District; and the case having been submitted on written stipulations, and the Court having fully considered the same, hereby makes the following special findings of fact:

I

The Court finds that the Plaintiff, Obispo Oil Company, is, and was at all times hereinafter mentioned, a corporation organized under the laws of the State of California, and having its principal offices and place of business at San Luis Obispo, California.

II

That the Defendant, Galen H. Welch; was, from April 6, 1926, to and including June 30, 1933, the Collector of Internal Revenue for the Sixth Collection District of California, duly commissioned and acting pursuant to the laws of the United States, and resided and had his office in the County of Los Angeles, State of California.

III

That the Plaintiff, prior to the year 1914, was engaged in the development and production of crude petroleum. It was a successor to a claim of title held under a placer mining location, made in the year 1900, covering forty acres of land in the Kern River District of California, described as follows:

The Southeast Quarter (SE¼) of the Southwest Quarter (SW¼) of Section Thirty-two (32) of Township Twelve (12) North, Range Twenty-three (23) West, San Bernardino Base and Meridian.

28

IV

That said land as of June 9, 1909, was classified by the Secretary of the Interior as oil bearing. That said land came within the effect of a withdrawal order issued by President Taft on September 27, 1909, which purported to temporarily withdraw designated areas from all forms of "location, settlement, selection, filing, entry, or disposal." Said withdrawal order contained the condition that "all locations or claims existing and valid at this date may proceed to entry in the usual manner after field investigation and examination."

V

At the date of the withdrawal order, Plaintiff had made exploration for oil but had not at the time discovered same, but did make such discovery in June 1910. That notwithstanding said order of withdrawal, Plaintiff maintained possession of the land in question and drilling operations were prosecuted. In December 1913 a well was completed, which became a heavy producer of oil. Other wells were thereafter drilled and the output was thereby increased.

VI

That on or about March 1, 1914, the United States of America filed a bill of complaint in the United States District Court of California, Southern District, against the Plaintiff and others to oust them from possession and to recover proceeds of oil theretofore produced.

VII

That said Court in that action appointed, on or about March 11, 1914, a receiver to take charge of the property with direction
29 to impound the proceeds therefrom pending termination of the litigation. From that time until the year 1920, the Plaintiff proceeded to produce and market oil under the direction of the receiver, making return to the latter of the proceeds thereof.

VIII

That during the period in question the Plaintiff kept its books on an accrual system of accounting, and that the Plaintiff accounted for the income received from the sales of oil during each of the years 1914 to 1920 as separate and independent years, and on its books charged the receiver with the amounts so referred to.

IX

That for each year during the incumbency of the receiver, the Plaintiff made its income tax return to the United States Government, and therein accounted for income and profits as though it were in undisputed ownership and possession.

X

That on or about December 24, 1919, the United States District Court entered its Decree in favor of the United States Government, which provided in part as follows:

"Second. That neither of the defendants nor any of them had at any time, or has now any estate, right, title, or interest whatsoever in or to said Southwest Quarter (SW¼) Section Thirty-two (32) Township Twelve (12) North of range Twenty-three (23) West San Bernardino Base and Meridian, or in or to any petroleum oil, gas, or other minerals therein contained; and all notices, deeds, leases, and other muniments of title under which the defendants or any of them claim, be and they hereby are and each of them hereby is cancelled, set aside and declared null and void from the inception thereof.

"Third. That the equitable title as well as the legal title to said Southwest Quarter (SW¼) of Section Thirty-two (32) Township Twelve (12) North of Range Twenty-three (23) West of the San Bernardino Base and Meridian, and the petroleum, oil, gas, and other minerals therein contained is now and has been at all times mentioned in the Bill of Complaint herein in the plaintiff United States of America free from any claim of defendants or either or any of them.

"Fourth. That the receiver herein is directed to turn over to the plaintiff possession of said land, together with all fixtures thereon or thereto attached upon the filing and approval of his final accounts."

XI

That thereafter the Plaintiff herein perfected its appeal to the United States Circuit Court of Appeals for the Ninth Circuit, claiming that it was holding under a valid location which, having been completed prior to the withdrawal order of September 27, 1909, was unaffected thereby.

XII

That in June, 1910, Congress passed an Act, 36 Stat. L. 847 (amended August 1912, 37 Stat. L. 497), giving express authority to the President to issue withdrawal orders, with the limitation that the rights of bona fide occupants or claimants of oil or gas lands, who at the date of the withdrawal order were in diligent prosecu-

tion of work leading to discovery, should not have their right impaired.

31

XIII

Congress passed an Act, approved February 25, 1920, entitled "An Act to promote the mining of coal, phosphate, oil, oil shale, gas, and sodium on the public domain", providing in part as follows:

"SEC. 18. That upon relinquishment to the United States, filed in the general Land Office within six months after the approval of this act, of all right, title, and interest claimed and possessed prior to July 3, 1910, and continuously since by the claimant or by his predecessor in interest under the pre-existing placer mining law to any oil or gas bearing land upon which there has been drilled one or more oil or gas wells to discovery embraced in the executive order of withdrawal issued September 27, 1909, and not within any naval petroleum reserve, and upon payment as royalty to the United States of an amount equal to the value at the time of production of one-eighth of all the oil or gas already produced except oil or gas used for production purposes on the claim, or unavoidably lost, from such land, the claimant, or his successor, if in possession of such land, undisputed by any other claimant prior to July 1, 1919, shall be entitled to a lease thereon from the United States for a period of twenty years, at a royalty of not less than 12½ per centum of all the oil or gas produced except oil or gas used for production purpose on the claim, or unavoidably lost. * * *"

XIV

That on April 30, 1920, while its appeal was still pending before the Circuit Court of Appeals, Plaintiff herein made request to relinquish all its right, title, and interest claimed and possessed and take a lease as provided by said Act of February 25, 1920.

32

XV

That said request was approved by the Commissioner of the General Land Office, who reported his view to the Secretary of the Interior, in the course of which communication he said: "I have, therefore, the honor to recommend that the Attorney General be requested, in the absence of any objection which may be a bar to such action, to cooperate with this department with a view to securing a dismissal of the suit, the payment to the United States of the ⅛ value of past production, and the release of the remaining funds to the applicant company. I have also to recommend that the applicant be granted a lease, substantially in the form set out in the leasing regulations, for a term of twenty years, with a provision for the payment of the royalty prescribed in the leasing regulations."

XVI

That on April 30, 1920, the Plaintiff herein filed in the United States Land Office at Los Angeles, California, its unconditional quitclaim to the land in question and, on November 29, 1920, the Plaintiff herein paid to the Federal Reserve Bank of San Francisco, California, for the credit of "Receiver of Public Moneys, United States Land Office, Los Angeles, account Lease Application 032892", the principal amount of $248,406.83, with interest of $6,317.81, representing an amount equal to 1/8 of the value at the time of production of the oil and gas theretofore produced.

XVII

That on November 29, 1920, the Circuit Court of Appeals for the Ninth Circuit, directed, in accordance with stipulation, a man-
33 date to the United States District Court ordering a discharge of the judgment therein against the Obispo Oil Company and the turning over to said Company by the receiver of possession of the land, together with all funds impounded by order of said Court. That on November 30, 1920, an order was entered in said District Court complying with said mandate, and the receiver turned over to Plaintiff herein all the moneys and other assets theretofore impounded by order of said Court.

XVIII

That a considerable part of the impounded proceeds were represented by Liberty Bonds, in which the receiver had made investment at a cost of $891,607.62. Said bonds, when delivered by receiver to the Plaintiff herein, had a market value of $844,146.25, or $47,461.37 less than their cost.

XIX

That the Commissioner of Internal Revenue, upon audit of Plaintiff's income and profits tax return for the calendar year 1920, charged as income for that year the total value of the property relinquished by the receiver to the Plaintiff (and an additional $159,751.56, representing proceeds from the sale of oil produced prior to March 11, 1914, under certain Agreements with the Standard Oil Company, which amounts were never in the possession or under the control of the Receiver), included in which were the Liberty Bonds at their cost. That Plaintiff had reported in said return for 1920 only the income from oil and gas produced during said calendar year.

34 XX

That as a result of said action, the Commissioner of Internal Revenue increased Plaintiff's taxable net income in the amount of

$1,378,077.32, and assessed an additional tax on account thereof in the amount of $264,017.74, together with interest in the amount of $2,144.69, or a total of $266,162.43.

XXI

That the Defendant exacted from Plaintiff, and the plaintiff paid under protest to Defendant on July 23, 1926, said sum of $266,162.43.

XXII

Thereafter, on December 6, 1927, Plaintiff filed in the manner provided by law, a claim for refund in the amount of $266,162.43 so paid, the grounds for which were stated in the claim as follows:

"This claim is based upon the following propositions of law and fact:

"(1) The Commissioner of Internal Revenue erred in determining that certain impounded funds released to the taxpayer during the year 1920 constituted taxable income to the taxpayer during that year. The excess-profits and income tax should have been computed only on the taxpayer's net income from operations for the year 1920, excluding in its entirety the impounded funds released to the taxpayer during that year. The amount refundable to the
35 taxpayer as a result of this error in computing its tax liability for the year 1920 is $264,017.74, as per Exhibit A attached hereto.

"The impounded funds in question constituted moneys collected by a Receiver during the years 1914 to 1919, inclusive, which Receiver was appointed by the U. S. District Court to act pending the determination of litigation between the taxpayer and the United States. The Receiver was at all times in possession and control of the entire properties of the taxpayer. On the termination of this litigation the funds accumulated by the Receiver were turned over to the taxpayer.

"(2) In the alternative, regardless of whether or not said impounded funds are taxable to this taxpayer in the year 1920, the taxpayer is entitled to a refund for tax overpaid for that year of $101,485.29, the details of which are shown on Exhibit B attached hereto. This adjustment is based upon the two following propositions:

"(a) The impounded funds in question were released to the taxpayer December 6, 1920, and consisted largely of U. S. Government Bonds. The market value of said bonds at date of release was less than original cost by the amount of $47,822.62. The Commissioner of Internal Revenue erroneously included these bonds in taxpayer's income for 1920 at their original cost. The net taxable income of the taxpayer for the year 1920 should, therefore, in any event be reduced by said amount of $47,822.62;

36 "(b) In determining taxpayer's depletion deduction on said impounded funds for the year 1920 the Commissioner of In-

ternal Revenue erroneously employed the rates prevailing and allowable in the years in which the oil was actually extracted instead of determining the deduction on the basis of depletion actually sustained. The taxpayer, therefore, on the basis of depletion actually sustained, and even though said impounded funds are all included in its taxable income for the year 1920, is entitled to an additional deduction for depletion for the year 1920 as set forth in Schedule B attached hereto, which additional depletion represents depletion actually sustained.

"(3) The profits-tax rate of this taxpayer for the year 1920 has been determined on the basis of Sections 327 and 328 of the Revenue Act of 1918, based upon the abnormality in income resulting from the inclusion in that year's income of said impounded funds. The income of the taxpayer for the year 1920 will be abnormal and disproportionate to the income of similar taxpayers engaged in the same general line of business for the year 1920 even though the adjustments of income resulting from the adjustment of the value of said securities set forth in 2 (a) above and the additional depletion set forth in 2 (b) above are allowed. The same profits-tax rate heretofore employed, therefore, should be used in determining the taxpayer's net taxable income for the year 1920 after making the adjustments set forth in (2) above."

37 That on or about February 14, 1928, the Commissioner of Internal Revenue rejected Plaintiff's said claim for refund and no part of the taxes and interest covered thereby has ever been repaid or refunded to Plaintiff. That Plaintiff filed its original Complaint herein on December 2, 1928.

XXIII

That in computing the taxable net income of Plaintiff for the calendar year 1920, the Commissioner of Internal Revenue allowed a depletion deduction of $152,571.96, computed on the basis of the production for the various years 1914 to 1920, under the laws then in force, as shown in the right hand column of the depletion schedule set forth in paragraph XXV hereof.

XXIV

That the plaintiff, on or about December 23, 1913, made discovery of oil as defined in Section 234 (a) (9), Revenue Act of 1918, on the lands in question; the fair market value and the oil content at date of such discovery was greatly in excess of the cost of said property; and that the said oil content was, prior to December 23, 1913, unknown.

XXV

That as of March 10, 1914, the oil content of the property, the value thereof, and the production, depletion unit and depletion sustained on the discovery basis was as follows:

38 *Obispo Oil Company* Lessee 7/8 interest

[40 acres SW¼ of SW¼ of Sec. 33-12-23 Kern County, Cal.]

Date	Capital Sum returnable through depletion at beginning of year	Estimated Recoverable Reserves at Beginning of Year	Production in Barrels	Unit per BBL	Depletion Sustained	Depletion Allowed by Commissioner
			Discovery—December 23, 1913			
3/10/14	1,363,780.00	4,998,944	1,385,486	.27281	377,974.44	28,928.93
1915	965,805.56	3,613,458	321,045		87,584.29	6,703.42
1916	898,221.27	3,292,413	118,231		32,254.60	4,970.99
1917	865,966.07	3,174,182	162,778		44,407.47	6,843.84
1918	821,559.20	3,011,404	110,724		30,206.61	30,206.61
1919	791,352.59	2,900,680	128,889		35,162.21	35,162.21
to 4/30 1920	756,190.38	2,771,791	49,894		13,611.58	13,611.58
from 5/1/20	742,578.80	2,721,897	93,834		26,144.47	26,144.47
	716,434.33	2,626,063				
			2,372,881		$647,345.67	$152,571.96

39 XXVI

That the total depletion sustained on the discovery value basis on the oil produced from March 10, 1914, to December, 1920, was $647,345.67.

XXVII

The net income of the Plaintiff, for the taxable year 1920, as otherwise determined, shall be increased in the amount of $40,683.00, representing amounts accrued and paid during said year as capital expenditures in connection with the litigation with the United States Government in the case of United States of America vs. G. W. McCutcheon, Obispo Oil Company, et al., which amount was erroneously allowed as a deduction by the Commissioner of Internal Revenue.

XXVIII

That in determining the taxable net income of Plaintiff for the year 1920, the Commissioner of Internal Revenue made an allowance of $126,427.49 for depletion with respect to oil and gas produced prior to April 20, 1920.

XXIX

During the year 1926, and contemporaneously with the final determination and assessment of the deficiency for the taxable year 1920, here in controversy, the Commissioner of Internal Revenue also audited the returns of the Plaintiff for the taxable years 1914 to 1919 inclusive, and excluded from the taxable income therein, the amounts of impounded income and other items which were added to the taxable income for 1920. As a result of said audit, the Treas-

ury Department refunded to the Plaintiff the following amounts of taxes and interest for said earlier years:

40

Taxable Year	Refund of Tax	Interest
1914	$6,380.60	$2,132.86
1915	1,292.51	404.38
1916	1,749.53	522.92
1917	25,492.40	5,510.98
1918	41,517.87	10,573.58
1919	31,890.17	7,339.16
Total	$108,323.08	$26,483.88

XXX

The Commissioner of Internal Revenue determined the profits taxes of Plaintiff for the calendar year 1920 under the provisions of Sections 327 and 328, Revenue Act of 1918, in the total amount of $142,765.73, or at the rate of 9.67 per cent of Plaintiff's income, subject to profits tax, of $1,476,330.52 for that year. The Commissioner determined the income tax of Plaintiff for 1920 as follows:

Net income		$1,476,330.52
Less:		
Profits tax, Section 328	$142,765.73	
Interest on U. S. obligations not exempt	86,134.16	
Exemption	2,000.00	230,899.89
Balance subject to 10% tax		$1,245,430.63
Amount of tax at 10%		124,543.06

XXXI

That the 1920 income, as determined by the Commissioner of
41 Internal Revenue, is to be reduced $47,461.37, representing an over-statement in the value of Liberty Bonds turned over to the Plaintiff by the Receiver in 1920.

XXXII

That the Plaintiff is entitled to a reduction of its gross income for the taxable year 1920, as otherwise determined, in the amount of $159,751.56, representing proceeds from the sale of oil produced prior to March 11, 1914, together with interest during the years 1914 to 1919, inclusive, under certain Agreements with the Standard Oil Company, which amounts were never in the possession or under the control of the Receiver.

CONCLUSIONS OF LAW

As a conclusion of law from the foregoing facts, the Court determines that it has jurisdiction of the subject matter of this action, to the extent of determining the correct amount of income tax, even though the profits taxes of Plaintiff for the calendar year 1920 were determined under the special assessment provisions of Sections 327 and 328, Revenue Act of 1918; 40 Stat. 1092–1093.

As a conclusion of law from the foregoing facts, the Court determines that Plaintiff's net income as determined by the Commissioner was excessive in an amount of $47,461.37 on account of over-statement in the value of Liberty Bonds turned over to Plaintiff by the receiver in 1920; and in a further amount of $159,751.56, representing proceeds of oil production prior to the receivership, together with interest on said sums during the taxable years 1914 to 1919, inclusive, which amounts were never in the possession or under the control of the receiver.

42 As a conclusion of law from the foregoing facts, the Court finds that Plaintiff's net income as determined by the Commissioner was understated in an amount of $40,683.00, representing capital expenditures in connection with litigation which were erroneously allowed as deductions.

As a conclusion of law from the foregoing facts, the Court determines that the amount of money and the Liberty Bonds received by Plaintiff from the receiver in 1920 did not constitute a gift, but represented taxable gross income of Plaintiff for that year.

As a conclusion of law from the foregoing facts, the Court determines that Plaintiff is entitled to depletion deductions only on oil and gas produced after it received the lease, namely, April 20, 1920, and is not entitled to any deduction for depletion on oil and gas produced prior to said date; and that Plaintiff's net income as determined by the Commissioner was understated in an amount of $126,427.49, representing the depletion deduction allowed by the Commissioner on oil and gas produced prior to April 20, 1920.

As a conclusion of law from the foregoing facts, the Court determines that Plaintiff's net income as determined by the Commissioner was excessive in the net amount of $40,102.44, upon which the income tax at the rate of 10 per cent was $4,010.24; that the defendant, Galen H. Welch, erroneously and illegally collected from Plaintiff the sum of $4,010.24, and that Plaintiff is entitled to recover

43 from Defendant the sum of $4,010.24, together with interest thereon at the rate of six (6) per cent per annum from July 23, 1926, as provided by law.

The Plaintiff is also entitled to cost of suit herein.

That judgment be entered against the Respondent accordingly.

Dated: September 23, 1935.

WM. P. JAMES,
United States District Judge.

Approved as to form according to Rule 44:

JOSEPH D. PEELER,
MELVIN D. WILSON,
Counsel for Plaintiff.
PEIRSON M. HALL,
United States Attorney,
ALVA C. BAIRD,
Assistant United States Attorney,
Counsel for Defendant.

An exception is noted in favor of the Plaintiff to the findings. An exception is noted in favor of the defendant on the question of jurisdiction. None other being claimed.

WM. P. JAMES,
U. S. Dist. Judge.

[File endorsement omitted.]

44 In United States District Court for the Southern District of California, Central Division

No. 3334–J

OBISPO OIL COMPANY, A CORPORATION, PLAINTIFF

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA, DEFENDANT

Judgment on findings

Filed Dec. 7, 1935

This cause having come on regularly for trial on the 21st day of October 1933, before the Court, sitting without a jury, trial by jury having been waived by written stipulation filed, Joseph D. Peeler, Esq., and Melvin D. Wilson, Esq., of Miller, Chevalier, Peeler & Wilson, appearing as Attorneys for Plaintiff, and Peirson M. Hall, Esq., United States Attorney for the Southern District of California, Ignatius F. Parker, Esq., and Alva C. Baird, Esq., Assistant United States Attorneys for the said District, appearing as Attorneys for Defendant, and the trial having been proceeded with, and Stipulations and documentary evidence on behalf of the respective parties having been introduced and the cause having been submitted to the Court for consideration and decision, and the Court, after due deliberation, having rendered its decision and filed its findings and ordered that judgment be entered in favor of Plaintiff in accordance with said findings;

Now, therefore, by virtue of the law, and by reason of the findings aforesaid, it is considered by the Court that the Plaintiff have judgment in the amount of Four Thousand and Ten and 24/100 Dollars ($4,010.24), plus interest at the rate of six per cent (6%) per
45 annum from July 23, 1926, as provided in Section 615, Revenue Act of 1928, together with Plaintiff's costs of action herein expended taxed at $46.75.

Judgment rendered this 7 day of December 1935.

WM. P. JAMES,
United States District Judge.

Certificate of probable cause

The Court certifies that the Defendant Galen H. Welch, Collector of Internal Revenue, exacted and received payment of the moneys recovered herein in the performance of his official duty, and that there was probable cause for the act done by the Defendant, and that he was acting under the directions of the Secretary of the Treasury, or other proper officer of the Government.

WM. P. JAMES,
Judge of the United States District Court.

Approved as to form as required by Rule 44.

PEIRSON M. HALL,
United States Attorney,
By ALVA C. BAIRD,
Assistant United States Attorney,
Attorneys for Defendant.

MILLER, CHEVALIER, PEELER & WILSON,
By MELVIN D. WILSON,
Attorneys for Plaintiff.

Judgment entered and recorded Dec. 7, 1935. R. S. Zimmerman, Clerk. By Murray E. Wire, Deputy Clerk.

[File endorsement omitted.]

46 In United States District Court

Engrossed bill of exceptions

Filed Dec. 18, 1935

Be it remembered, that on the 21st day of October 1933 the above entitled cause came on for trial before this Court, Honorable Wm. P. James presiding, the Court sitting without a jury, trial by jury having been waived in writing by counsel for the respective parties.

The case was submitted on written Stipulations of Facts, and a further Stipulation introducing into evidence all the evidence introduced in the former trial of this case before this Court, excepting the evidence in the former trial as may be inconsistent with, or affected by, the facts stipulated in the Stipulation filed at the second trial. Briefs were filed and the cause submitted for decision.

Plaintiff appeared by Messrs. Miller, Chevalier, Peeler & Wilson, by Joseph D. Peeler, Esq., and Melvin D. Wilson, Esq., and the Defendant appeared by Peirson M. Hall, Esq., United States Attorney for the Southern District of California, Ignatius F. Parker, Esq., and Alva C. Baird, Esq., Assistant United States Attorneys for the said District.

The Court, on May 21, 1934, made and entered a Memorandum of Conclusions and Order for Judgment, instructing the parties to prepare, together, the Findings of Fact and Conclusions of Law to be entered, stating that exception would be noted in favor of the

Plaintiff, and also in favor of the Defendant on the adverse ruling on the question of jurisdiction.

On September 23, 1935, the parties, pursuant to the Court's order, filed Findings of Fact and Conclusions of Law, which the
47 Court signed on the date mentioned. The Court allowed an exception to the Findings in favor of Plaintiff, and an exception in favor of Defendant on the question of jurisdiction, and wrote on the end of the Conclusions of Law the following: "An exception is noted in favor of the Plaintiff to the findings. An exception is noted in favor of the Defendant on the question of jurisdiction. None other being claimed. Wm. P. James, U. S. Dist. Judge."

Stipulation re approval of bill of exceptions

It is hereby stipulated and agreed by and between Attorneys for Plaintiff and Defendant that the foregoing Bill of Exceptions has been presented in time, that it contains all evidence given, and proceedings had in the trial of this action material to the appeal of Plaintiff, and that it may be approved, allowed, and settled by the Judge in the above entitled Court as correct in all respects, and that the same shall be made a part of the record in said case and be the bill of exceptions therein, and that said Bill of Exceptions may be used by either Plaintiff or Defendant upon any appeal taken by either Plaintiff or Defendant.

Dated: December 13, 1935.

MILLER, CHEVALIER, PEELER & WILSON,
By JOSEPH D. PEELER,
By MELVIN D. WILSON,
Attorneys for Plaintiff.

PEIRSON M. HALL,
United States Attorney.

ALVA C. BAIRD,
Assistant United States Attorney.

48 *Order approving and settling bill of exceptions*

The foregoing Bill of Exceptions, duly proposed and agreed upon by counsel for the respective parties, is correct in all respects and is hereby approved, allowed, and settled and made a part of the record herein, and said Bill of Exceptions may be used by the parties, Plaintiff or Defendant, upon any appeal taken by either party, Plaintiff or Defendant.

Dated: December 18, 1935.

WM. P. JAMES,
United States District Judge.

(Endorsed:) Received copy of the within Engrossed Bill of Exceptions this 13 day of December 1935. Peirson M. Hall, Alva C. Baird.

[File endorsement omitted.]

49 In United States District Court

Petition for appeal

Filed Dec. 23, 1935

TO THE HONORABLE JUDGE OF THE UNITED STATES DISTRICT COURT, IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION:

The above-named Plaintiff, feeling aggrieved by the decree rendered and entered in the above-entitled cause on the 7th day of December, 1935, does hereby appeal from said decree to the Circuit Court of Appeals for the Ninth Circuit, for the reasons set forth in the assignment of errors filed herewith, and Plaintiff prays that this appeal be allowed and that citation be issued as provided by law, and that a transcript of the record, proceedings, and documents upon which said decree was based, duly authenticated, be sent to the United States Circuit Court of Appeals for the Ninth Circuit, under the rules of such Court in such cases made and provided.

And your Petitioner further prays that the proper order relating to the required security to be required of Plaintiff be made.

Dated: December 13, 1935.

MILLER, CHEVALIER, PEELER & WILSON,
By JOSEPH D. PEELER,
By MELVIN D. WILSON,
Attorneys for Plaintiff.

(Endorsed:) Received copy of the within Petition for Appeal this 13 day of December 1935, Peirson M. Hall, Alva C. Baird, Attorney for defendant.

[File endorsement omitted.]

50 In United States District Court

[Title omitted.]

Assignment of errors

Filed Dec. 23, 1935

Now comes the Plaintiff in the above entitled cause, and files the following assignment of errors upon which Plaintiff will rely upon its prosecution of the appeal in the above entitled cause from the decree made by this Honorable Court on the 7th day of December, 1935.

1. The Court erred in failing to find that the amount of money and the Liberty Bonds, received by the Plaintiff from the Receiver in 1920, constituted a gift exempt from income taxation.

2. The Court erred in failing to find that Plaintiff was entitled to an additional depletion deduction, in 1920, of $516,598.10, com-

51 puted under Section 234 (a) of the Revenue Act of 1918, on the discovery basis, on the oil produced during the period of the receivership.

Wherefore, the Appellant prays that said Decree be modified and that said United States District Court for the Southern District of California, Central Division, be ordered to enter a decree modifying the decision in said cause.

Dated: December 13, 1935.

MILLER, CHEVALIER, PEELER & WILSON,
By JOSEPH D. PEELER,
By MELVIN D. WILSON,
Attorneys for Plaintiff and Appellant.

(Endorsed:) Received copy of the within Assignment of Errors this 13 day of December 1935. Peirson M. Hall, Alva C. Baird, Attorneys for Defendant.

[File endorsement omitted.]

52 In United States District Court

Order allowing appeal

Filed Dec. 23, 1935

Upon reading the Petition for Appeal of the Plaintiff and Appellant, it is hereby ordered that an appeal to the Circuit Court of Appeals for the Ninth Circuit, from the decree heretofore filed and entered herein, be and the same is hereby allowed, and that a certified transcript of the record, testimony, exhibits, stipulations and all proceedings be forthwith transmitted to the said Circuit Court of Appeals for the Ninth Circuit.

It is further ordered that the bond on appeal to be filed by Plaintiff be fixed at the sum of $250.00 and the same act as a bond for cost on appeal.

Dated: December 23, 1935.

WM. P. JAMES,
United States District Judge.

(Endorsed:) Received copy of the within Order Allowing Appeal this 13 day of December, 1935. Peirson M. Hall, Alva C. Baird.

[File endorsement omitted.]

53 [Bond on appeal for $250.00 approved and filed Dec. 23, 1935, omitted in printing.]

55 In United States District Court

Stipulation re appeal

Filed Dec. 24, 1935

It is hereby stipulated between the parties hereto, through their respective Counsel, as follows:

That, subject to approval of the Court, the appeal taken by the Plaintiff may be docketed with the Clerk of the United States Circuit Court of Appeals, for the Ninth Circuit, on or before December

26, 1935, in order that the appeal may be placed on the 1936 Spring Calendar, and

That the Plaintiff may have until January 6, 1936, within which to print and file the Transcript of Record with the Clerk of the Circuit Court.

Dated at Los Angeles, California, December 23, 1935.

MILLER, CHEVALIER, PEELER & WILSON,
By MELVIN D. WILSON, *Attorney for Plaintiff.*
PEIRSON M. HALL, *United States Attorney,*
ALVA C. BAIRD,
Assistant United States Attorney,
Attorneys for Defendant.

Approved and it is so ordered.

WM. P. JAMES,
Judge of the United States District Court.

[File endorsement omitted.]

56 In United States District Court

Praecipe for transcript of record

Filed Dec. 24, 1935

TO THE CLERK OF THE UNITED STATES DISTRICT COURT, IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION:

Please issue a certified transcript of record in the above entitled case on appeal to the Circuit Court of Appeals for the Ninth Circuit, consisting of the following:

1. Amended Complaint.
2. Answer to Amended Complaint.
3. Stipulation Waiving Jury.
4. Findings of Fact and Conclusions of Law.
5. Memorandum of Conclusions and Order for Judgment.
6. Judgment on Findings.
7. Engrossed Bill of Exceptions.
8. Petition for Appeal.
9. Assignment of Errors.
10. Order Allowing Appeal, and Order Fixing Cost Bond.
11. Bond to Cover Costs on Appeal.
12. Citation on Appeal.
13. Stipulation, dated December 23, 1935.
14. Praecipe.
15. Motion for Judgment.

MILLER, CHEVALIER, PEELER & WILSON,
By MELVIN D. WILSON,
Attorneys for Plaintiff.

57 Counsel for Defendant does not desire to file a counter-praecipe.

PEIRSON M. HALL,
United States Attorney,
ALVA C. BAIRD,
Assistant United States Attorney,
Attorneys for Defendant.

(Endorsed:) Received copy of the within Praecipe for Transcript of Record this 24 day of December 1935, Peirson M. Hall, By E. H. Mitchell, Attorney for Defendant.

[File endorsement omitted.]

58 [Clerk's Certificate to foregoing transcript omitted in printing.]

61 [Names and addresses of attorneys omitted in printing.]

62 [Citation in usual form showing service on Melvin D. Wilson filed March 9, 1936, omitted in printing.]

63 In United States District Court for the Southern District of California, Central Division

No. 3334–J

OBISPO OIL COMPANY, A CORPORATION, PLAINTIFF

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH DISTRICT OF CALIFORNIA, DEFENDANT

Petition for cross-appeal

Filed March 7, 1936

To the above-entitled Court and to the Honorable William P. James, Judge thereof:

Your petitioner, the defendant in the above-entitled cause, respectfully shows that the Obispo Oil Company, a corporation, the plaintiff in the above-entitled cause, has been allowed an appeal herein from the Judgment entered herein on the 7th day of December
64 1935, in this cause, and your petitioner also considers himself aggrieved by such Judgment as entered herein in favor of said plaintiff, and therefore, hereby prays for the allowance of a Cross-Appeal from the United States District Court for the Southern District of California to the United States Circuit Court of Appeals for the Ninth Circuit from said Judgment and in connection with

said Petition hereby presents Assignment of Errors dated March 6, 1936.

Dated March 6, 1936.

Peirson M. Hall,
PEIRSON M. HALL,
United States Attorney.
E. H. Mitchell,
E. H. MITCHELL,
Special Assistant, U. S. Attorney.
Alva C. Baird,
ALVA C. BAIRD,
Assistant United States Attorney.

[File endorsement omitted.]

65 In United States District Court

No. 3334–J

Defendant and cross-appellant's assignment of errors

Filed March 7, 1936

The Defendant and Cross-Appellant above-named makes and files the following Assignment of Errors upon which he will rely in the prosecution of his cross-appeal from the judgment of this Court entered herein on the 7th day of December 1935:

I

The Court erred in rendering judgment against the Defendant and in favor of the Plaintiff in the sum of $4,010.24, together with interest thereon and costs, in that by reason of the pleadings and the record upon which the case is submitted Plaintiff is not, as a matter of law, entitled to recover the whole or any part of the sum sued for herein.

II

The Court erred in rendering judgment against the Defendant and in favor of the Plaintiff herein for the reason that the Court has no jurisdiction over the subject matter of this action, the tax sought to be recovered having been determined and assessed by the Commissioner of Internal Revenue of the United States under the special assessment provisions of Sections 327 and 328 of the Revenue Acts of 1918 and 1921 (40 Stat. 1092, 1093).

66 WHEREFORE the Defendant prays that the Judgment entered herein be reversed and that a Judgment be ordered herein that

Plaintiff take nothing and that the Defendant have his costs and disbursements as provided by law.

Dated this 6th day of March 1936.

Peirson M. Hall,
PEIRSON M. HALL,
United States Attorney.
E. H. Mitchell,
E. H. MITCHELL,
Special Assistant, U. S. Attorney.
Alva C. Baird,
ALVA C. BAIRD,
Assistant United States Attorney.

[File endorsement omitted.]

67 In United States District Court

No. 3334-J

[Title omitted.]

Order allowing cross-appeal

Filed March 7, 1936

The Defendant herein, Galen H. Welch, Collector of Internal Revenue for the Sixth District of California, having filed his petition for cross appeal from the judgment entered herein against said Defendant, together with his assignment of errors herein,

It is hereby ordered that the cross appeal prayed for in said Petition of Defendant in the above-entitled cause be allowed.

Dated March 7, 1936.

Wm. P. James,
WILLIAM P. JAMES.

[File endorsement omitted.]

68 In United States Circuit Court of Appeals for the Ninth Circuit

No. 8079

[Title omitted.]

Stipulation re use of one transcript upon two appeals

Filed March 9, 1936

UNDOCKETED

Whereas a transcript of the record containing a Bill of Exceptions has been prepared and filed in above entitled Court by above named Plaintiff-Appellant, Obispo Oil Co., a corporation, in said appeal

numbered 8079, and such transcript contains all of the record necessary for a review of the issues raised in an appeal from the same Judgment by the Defendant-Appellant, Galen H. Welch, formerly Collector of Internal Revenue for the Sixth Collection District of California, in above entitled undocketed appeal,

Now, therefore, it is hereby stipulated and agreed by and between the adverse parties to each of above entitled appeals, that the
59 transcript of the record referred to above, including the Bill of Exceptions therein contained, may be used as the record in the appeal entitled Galen H. Welch, Defendant-Appellant, vs. Obispo Oil Co., a corporation, Plaintiff-Appellee, which appeal is at this time undocketed, together with a record of such other matters, pleadings, orders, and documents as Defendant-Appellant may desire to present in support of his appeal.

Dated this 9th day of March 1936.

MILLER, CHEVALIER, PEELER & WILSON,
By MELVIN D. WILSON,
Attorneys for Plaintiff-Appellee.

Peirson M. Hall,
PEIRSON M. HALL,
United States Attorney,
Alva C. Baird,
ALVA C. BAIRD,
Asst. U. S. Attorney,
E. H. Mitchell,
E. H. MITCHELL,
Spec. Asst. U. S. Attorney,
Attorneys for Defendant-Appellant.

[File endorsement omitted.]

70 In United States District Court

No. 3334–J

Praecipe for transcript of record

Filed March 10, 1936

To R. S. ZIMMERMAN,
Clerk of the United States District Court,
Southern District of California:

You will please issue a transcript of the Record in the above-entitled action and include therein the following papers:

1. Citation.
2. Petition for Cross-Appeal.
3. Assignment of Errors.
4. Order Allowing Cross-Appeal.

5. Clerk's Certificate and this Praecipe.
6. Stipulation re use of Record.

Dated this 6th day of March 1936.

PEIRSON M. HALL,
United States Attorney,
E. H. MITCHELL,
Special Asst., U. S. Attorney,
ALVA C. BAIRD,
Assistant U. S. Attorney,
Attorneys for defendant.

(Endorsed:) Received copy of the within Praecipe this 9th day of March 1936. Melvin D. Wilson of Miller, Chevalier, Peeler & Wilson, attorneys for Plaintiff.

[File endorsement omitted.]

71 [Clerk's Certificate to foregoing transcript omitted in printing.]

United States Circuit Court of Appeals for the Ninth Circuit

No. 8079

OBISPO OIL COMPANY, A CORPORATION, APPELLANT

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, APPELLEE

Upon appeal from the District Court of the United States for the Southern District of California, central division

Proceedings had in the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Wednesday, April 8, 1936

Before WILBUR, GARRECHT, and HANEY, Circuit Judges

Order of submission

Ordered appeal and cross-appeal in above cause argued by Mr. Joseph D. Peeler, counsel for Obispo Oil Company, and by Mr. L. W. Post, Special Assistant to the Attorney General, counsel for Collector, and submitted to the court for consideration and decision, with leave to counsel for Obispo Oil Company to file a further brief in five days.

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Monday, September 28, 1936

Before GARRECHT, DENMAN, and HANEY, Circuit Judges

Order directing filing of opinion and dissenting opinion and filing and recording of decree

By direction of the court, ordered that the opinion and dissenting opinion this day rendered by this court in above cause be forthwith filed by the clerk, and that a decree be filed and recorded in the minutes of this court in accordance with the opinion rendered.

115487—36

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 8079. September 28, 1936

OBISPO OIL COMPANY, A CORPORATION, APPELLANT

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, APPELLEE

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division

Before WILBUR, GARRECHT, and HANEY, Circuit Judges

HANEY, *Circuit Judge:* Appeal has been taken by Obispo Oil Company, a corporation, from a judgment entered in its favor for $4,010.24 in an action brought by it against appellee to recover $266,162.43, alleged to have been illegally exacted from appellant on account of additional income and profits taxes for the year 1920. Appellee has also appealed, but will hereinafter be referred to as appellee.

The findings of fact made by the trial court are not in dispute.

Appellant was a successor to a claim of title held under a placer mining location, made in the year 1900, covering forty acres of land in the Kern River District of California, and prior to the year 1914 was engaged in the development and production of crude petroleum.

The Secretary of the Interior classified the land in question as oil bearing on June 9, 1909. Such land was described in the Taft withdrawal order of September 27, 1909, which purported to temporarily withdraw such land from all forms of "location, settlement, selection, filing, entry, or disposal." The Taft order also contained the condition that "all locations or claims existing and valid at this date may proceed to entry in the usual manner after field investigation and examination."

In June 1910, Congress passed an Act (36 Stat. 847; amended, 37 Stat. 497) granting express authority to the President to issue withdrawal orders, with the limitation that the rights of bona fide occupants or claimants of oil or gas lands, who at the date of the withdrawal order were in diligent prosecution of work leading to discovery, should not have their right impaired.

At the date of the Taft order, appellant had made exploration for oil, but did not discover oil until June 1910. Thereafter appellant remained in possession of the land, commenced drilling operations, and in December 1913 completed a well which became a heavy producer of oil. Other wells were thereafter drilled and the output thereby increased.

About March 1, 1914, the United States commenced a suit against appellant and others to recover possession of the land and to recover the proceeds of oil theretofore produced (and sold?). About March

11, 1914, the court, in that suit, appointed a receiver to take charge of the property, with direction to impound the proceeds therefrom, pending termination of the litigation. From that time until November 1920, or shortly thereafter, appellant produced and marketed the oil under the direction of the receiver, making return to the latter of the proceeds thereof.

During the period in question, appellant kept its books on an accrual system of accounting, and accounted for the income received from the sales of oil during each of the years 1914 to 1920 as separate and independent years, and on its books charged the receiver with the amounts so referred to. For each of these years appellant made its income tax returns and therein accounted for income and profits as though it were in undisputed ownership and possession.

On December 24, 1919, a decree was entered in the suit mentioned in favor of the United States, adjudicating that "defendants nor any of them had at any time, or has now any estate, right, title, or interest whatsoever, in or to" the land hereinabove mentioned. Appellant thereafter appealed to this court, claiming that it was holding under a valid location which was completed prior to the withdrawal order of September 27, 1909, and was therefore unaffected thereby.

The Leasing Act of February 25, 1920,[1] provided that upon relinquishment to the United States by a claimant or his successor of his right, title and interest, in oil bearing land claimed under the preexisting placer mining law, and on which one or more oil or gas wells had been produced, and upon payment of certain amounts therein specified, the claimant or his successor would be entitled to a lease for a period of twenty years.

On April 30, 1920, while its appeal was still pending before this court, appellant made request to relinquish its interest and obtain a lease, and on that date paid for the benefit of the United States the respective amount of money required by the statute. The request was approved and on November 29, 1920, this court, in accordance with a stipulation, directed a mandate to the court below ordering a *discharge* of the decree, ordering the receiver to turn over possession of the land and the impounded funds to appellant. On November 30, 1920, an order was entered in the trial court complying with said mandate, and the receiver turned over to appellant all the money and assets theretofore impounded.

The trial court found that the commissioner had overstated certain items and had understated certain items. By subtracting the total of the latter items from the total of the former items, the court found a net overstatement, on which a tax was illegally exacted and gave judgment for the amount of such tax.

The Revenue Act of 1918, ch. 18, § 233 (40 Stat. 1057) provides that in the case of a corporation subject to tax, the term "gross in-

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[1] 41 Stat. 437 (Ch. 85, §18).

come" means the gross income as defined in § 213. Section 213 provides:

"That for the purposes of this title . . . the term 'gross income'—

"(a) Includes gains, profits, and income derived from . . . the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . .

"(b) Does not include the following items, which shall be exempt from taxation under this title:

. . . . . .

"(3) The value of property acquired by gift, bequest, devise, or descent (but income from such property shall be included in gross income); . . ."

Appellant first contends that the property turned over by the receiver was a gift, and therefore should not have been included as income.

In 1 Bouv. Law Dict. (Rawle's Third Rev.) 1352, a gift is defined as:

"A voluntary conveyance or transfer of property, that is, one not founded on the consideration of money or blood,"

In the instant case there was no absence of consideration, for appellant relinquished its claims, and the government relinquished most of the moneys impounded and granted a lease. There was no gift. This conclusion is supported by Burke-Divide Oil Co. v. Neal (C. C. A. 7), 73 F (2d) 857.

Edwards v. Cuba Railroad, 268 U. S. 628, 69 L. Ed. 1124, 45 S. Ct. 614, relied on by appellant, is an example of a pure gift, and is not contrary to our conclusion.

The other contention raised by appellant is that the trial court erred in disallowing as a deduction the sum of $152,571.96, which amount the commissioner had allowed for depletion, and which was computed on the basis of the production for the various years 1914 to 1920, under the laws then in force. Appellant contends that it is entitled to a deduction for depletion of $516,598.10, which is the depletion deduction permitted under the law (Revenue Act of 1918) existing in 1920 at the time when it received from the receiver its share of the impounded funds.

Appellee contends, as the trial court held, that appellant is entitled to depletion deductions only from the date of its lease with the United States, and is not entitled to any depletion deduction for oil and gas produced prior to that date. This contention is based on the proposition, that prior to the date of the lease, appellant had no economic interest in the oil and gas.

In appellant's brief, we find the following statement:

". . . If this court holds that these proceeds constituted taxable income to appellant in 1920, and that appellant is entitled to a depletion allowance in accordance with the law then in force, the parties have stipulated the amount which would be deductible."

Both appellant and appellee apparently concede that the depletion deduction allowed by the commissioner was erroneous. The issue is then, whether appellant had an economic interest in the oil and gas production prior to the date of the lease, for if appellant had an economic interest in the oil and gas prior to the date of the lease, it is entitled to a depletion deduction. Palmer v. Bender, 287 U. S. 551; Helvering v. Falk, 291 U. S. 183, 188; Signal Gasoline Corp. v. Commissioner (C. C. A. 9), 66 F. (2d) 886.

The burden of proof is on appellant to prove that it is entitled to a deduction for depletion. Signal Gasoline Corp. v. Commissioner (C. C. A. 9), 77 F. (2d) 728, 729.

Generally speaking, any person who has a right to share in the oil produced "has an economic interest in the oil, in place, which is depleted by production." Palmer v. Bender, supra, 557. The test in the instant case is, then, whether or not appellant had a right to share in the oil produced.

Law Opinion 1110 of the Treasury Department, published in the Internal Revenue Bulletin C. B. II–1, in 1923, held that the possessory rights, together with the claim of title asserted under the placer mining laws, which had not been finally adjudicated, were sufficient to show an economic interest in the property. The Board of Tax Appeals seems to have made like holdings in National Petroleum & Refining Co., 28 B. T. A. 569; Ralph W. Crews, 30 B. T. A. 615. Compare Champlin v. Commissioner (C. C. A. 10), 78 F. (2d) 905.

There seems to be little doubt that appellant had an economic interest in the property prior to the date of the lease. Congress made provision for recognition of all such claims, and the United States thereafter in fact recognized the interest by accepting a conveyance of such interest to itself. We hold that appellant had an economic interest in the property prior to the date of the lease.

We find nothing in the government's brief to answer other than the following proposition, which has already been answered:

(After stating certain facts outlined above)

"It is submitted that these facts disclose that the taxpayer had no interest whatever—legal, economic, or otherwise—in the property in question prior to 1920 . . ."

No case is cited to support such statement. It is also said:

". . . It is true that the Bureau of Internal Revenue has not been consistent in its application of the depletion provisions of the revenue acts in cases involving impounded funds. In recent years the courts have ruled on various aspects of the depletion question, and it would appear that the decision below is in agreement with the weight of judicial authority."

The Treasury Department ruled correctly on the matter in 1923. If the Commissioner had followed that ruling there would have been no occasion for inconsistency of application. The statement that the trial court's decision was in agreement with the weight of judicial authority is unsupported by any citations.

In appellee's cross-appeal the specification of error is that the trial court erred—

"In holding and deciding that it had jurisdiction of the subject matter of this action to the extent of determining the correct amount of income tax, even though the profits taxes of the taxpayer were determined under the special assessment provisions of the 1918 Act."

Title III of the Revenue Act of 1918 is entitled "War-Profits and Excess-Profits Tax." Sec. 327 (40 Stat. 1057, 1093) provides that in four instances, the tax shall be determined as provided in § 328. This latter section provides a method by which the Commissioner shall compute such profits-tax. The tax is distinct from the income tax under Title II. In computing the income tax a credit is allowed, by § 236 (b) for any profits-tax paid under Title III.

In the instant case appellant was subjected to a profits-tax which, in computing the income tax, was allowed as a credit. Appellee's contention is that since the special assessment of the profits-tax is a discretionary matter, entrusted to the Commissioner, over which, in the absence of fraud, the courts may not interfere, and since that tax must be allowed as a credit in computing the net income for income tax purposes, the discretionary character of the Commissioner's action also extends to the determination of the net income, and therefore the trial court could not interfere with the income tax as imposed.

This contention must be rejected. See Welch v. St. Helens Petroleum Co. (C. C. A. 9), 78 F. (2d) 631, 636. In computing income taxes, the right to credits enumerated by the statute are not dependent on the exercise of the Commissioner's discretion. Such credits are by statute extended to all alike, and the Commissioner may not, by exercising his discretion with regard to one credit, preclude a taxpayer from using other deductions permitted by statute, over which the Commissioner has no discretion. The Commissioner's discretion extends to the amount of this particular credit, and not to the right to claim deductions. A contrary holding would permit the Commissioner to enforce the statute or refuse to enforce it, according to his will, contrary to the intention of Congress.

Appellee cites Williamsport Co. v. U. S., 277 U. S. 551; Heiner v. Diamond Alkalai Co., 288 U. S. 502; Cleveland Automobile Co. v. U. S. (C. C. A. 6), 70 F. (2d) 365 (Certiorari denied, 293 U. S. 563); and Joseph Joseph & Bros. Co. v. U. S. (C. C. A. 6), 71 F. (2d) 389. We believe none of them to be contrary to this holding.

Reversed.

No. 8079

OBISPO OIL COMPANY, A CORPORATION, APPELLANT

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE, ETC., APPELLEE

WILBUR, Circuit Judge, dissenting:

I dissent and will briefly indicate the reason therefor. With the holding of the majority that the amount of money paid to the appel-

lant by the government in connection with the settlement was not a gift, I am in full accord. I think, however, that the amount so paid was income to the taxpayer which was not subject to a deduction for depletion of the value of the land or of the oil content thereof by reason of the extraction of oil therefrom, because the land did not belong to the petitioner. The settlement authorized by Congress and entered into by the petitioner by its terms which authorized a lease from the government, in effect required the petitioner to recognize that until the settlement, and after it, the title to the oil land and its oil content was in the United States. It follows that the petitioner by the terms of the settlement of its rights admitted and was required by the act of Congress to admit that it had no interest in the land which belonged to the United States and which had been withdrawn from entry. On the other hand, the government unqualifiedly admitted the right of the petitioner to seven-eighths of the money impounded in court. That this admission was predicated upon the fact that the money was derived from the sale of oil extracted from the land occupied by the petitioner did not give the petitioner any interest in the land. On the contrary, it was a part of the consideration paid by the government (the other part was the lease) for a contract by which the petitioner in legal effect disclaimed any interest therein. Consequently, it was the United States and not the petitioner which suffered depletion of its lands by reason of the production of oil therefrom.

(Endorsed:) Opinion. Filed Sep. 28, 1936. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8079

ORISPO OIL COMPANY, A CORPORATION, APPELLANT AND CROSS-APPELLEE

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, APPELLEE AND CROSS-APPELLANT

Judgment

Upon appeal and cross-appeal from the District Court of the United States for the Southern District of California, Central Division.

This cause came on to be heard on the Transcripts of the Record from the District Court of the United States for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is, reversed.

(Endorsed:) Judgment. Filed and entered September 28, 1936. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 8079

OBISPO OIL COMPANY, A CORPORATION, APPELLANT AND CROSS-APPELLEE

vs.

GALEN H. WELCH, COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, APPELLEE AND CROSS-APPELLANT

Certificate of Clerk, U. S. Circuit Court of Appeals for the Ninth Circuit to record certified under Rule 38 of the Revised Rules of the Supreme Court of the United States

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing two volumes, consisting of volume, labeled Transcript of Records, of fifty-nine pages, being record on appeal of Obispo Oil Company, and volume, labeled Supplemental Transcript of Record, of eleven pages, being papers on appeal of Welch, Collector, and proceedings in this Circuit Court of Appeals, being pages 12 to and including 22, to be a full, true, and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals for the Ninth Circuit, made pursuant to request of Mr. J. Stanley Reed, Solicitor General of the United States, counsel for Welch, Collector, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 16th day of December, A. D. 1936.

[SEAL] PAUL P. O'BRIEN, *Clerk.*

Order allowing certiorari

Filed February 8, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 41142. U. S. Circuit Court of Appeals, Ninth Circuit. Term No. 602. Galen H. Welch, Former Collector of Internal Revenue for the Sixth Collection District of California, petitioner, vs. Obispo Oil Co. Petition for a writ of certiorari and exhibit thereto. Filed December 28, 1936. Term No. 602 O. T. 1936.

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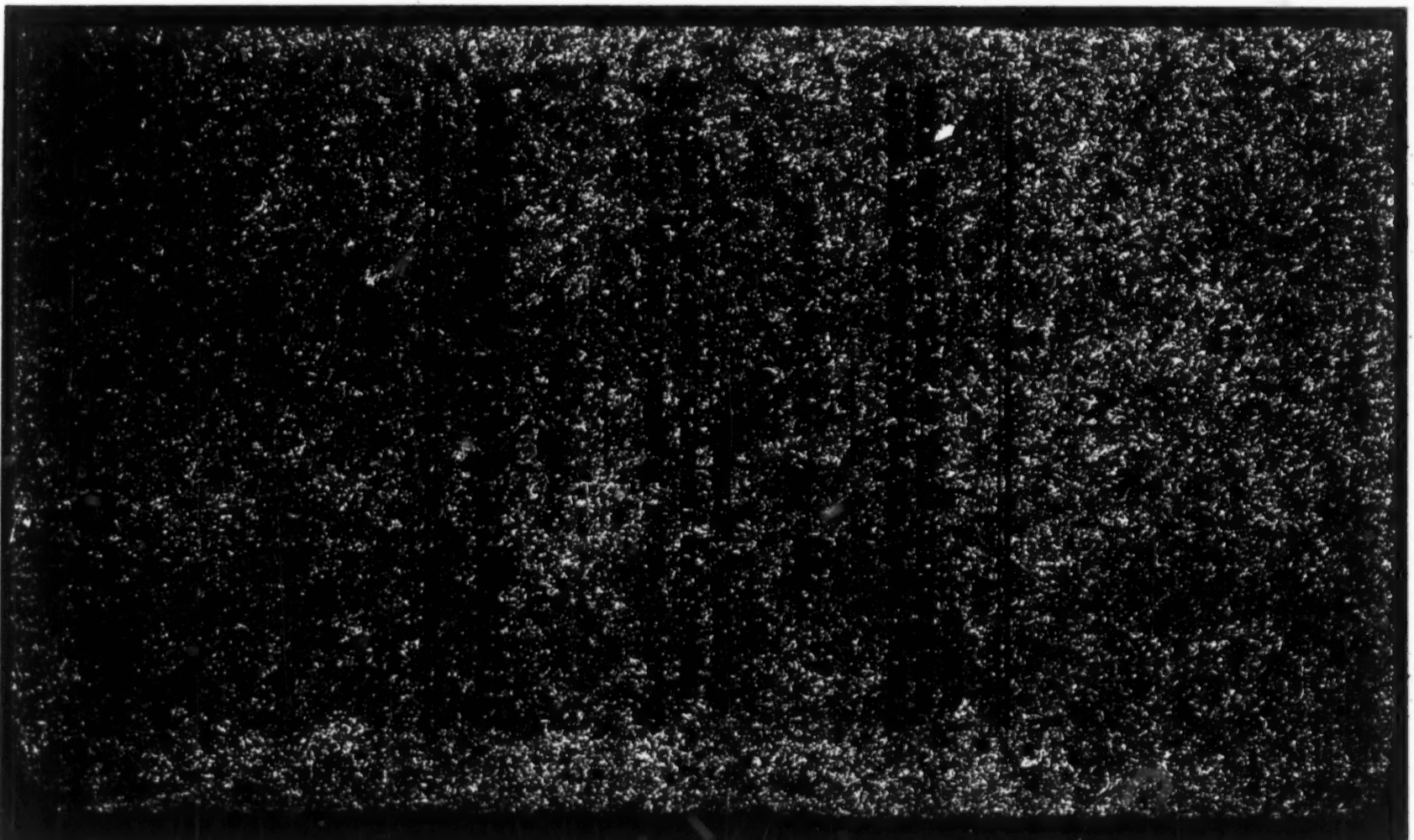

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	2
Specification of errors to be urged	4
Reasons for granting the writ	4
Conclusion	7
Appendix	8

CITATIONS

Cases:	
Bradford, W. H., & Co. v. *United States*, 6 F. Supp. 117	6
Central Iron & Steel Co. v. *United States*, 6 F. Supp. 115, certiorari denied, 293 U. S. 563	6
Cleveland Automobile Co. v. *United States*, 70 F. (2d) 365, certiorari denied, 293 U. S. 563	5, 6
Con P. Curran Printing Co. v. *United States*, 14 F. Supp. 638	6
Heiner v. *Diamond Alkali Co.*, 288 U. S. 502	5, 6, 7
Michigan Iron & Land Co. v. *United States*, 10 F. Supp. 563	5–6
United States v. *Henry Prentiss & Co.*, 288 U. S. 73	5, 7
Statute:	
Revenue Act of 1918, c. 18, 40 Stat. 1057:	
Sec. 327	8
Sec. 328	9

114740—36

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. —

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, PETITIONER

v.

OBISPO OIL CO., A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Galen H. Welch, former Collector of Internal Revenue for the Sixth Collection District of California, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit entered in the above cause on September 28, 1936. The Solicitor General requests that the review be limited solely to the question of jurisdiction hereinafter presented.

OPINIONS BELOW

The first opinion of the District Court of the United States for the Southern District of California is reported in 48 F. (2d) 872; the second

opinion (R. 25–43) is not reported. The opinion of the Circuit Court of Appeals is reported in 85 F. (2d) 860.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 28, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

After the Commissioner of Internal Revenue has granted a special assessment of profits taxes, pursuant to Sections 327 and 328 of the Revenue Act of 1918, may a court, in an action for refund of income taxes, revise the Commissioner's determination of the taxpayer's net income?

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 8–10.

STATEMENT

The District Court made special findings of fact (R. 27–41). Those pertinent to the question here involved may be summarized as follows:

Pursuant to Sections 327 and 328 of the Revenue Act of 1918, the Commissioner of Internal Revenue determined the profits taxes of the taxpayer for the calendar year 1920 to be $142,765.73, or 9.67% of its net income (R. 40). The taxpayer's

income tax for the same year was determined by the Commissioner as follows (R. 40):

Net income		$1,476,330.52
Less:		
Profits tax, Section 328	$142,765.73	
Interest on U. S. obligations, not exempt	86,134.16	
Exemption	2,000.00	
		230,899.89
Balance subject to 10% tax		1,245,430.63
Amount of tax at 10%		124,543.06

Thereafter, on December 6, 1927, the taxpayer filed a claim for refund, setting up several grounds for recovery (R. 34–36). The claim was rejected on or about February 14, 1928, and the taxpayer filed its original complaint in the District Court on December 2, 1928 (R. 37).

The District Court found that the Commissioner had overstated the net income by $40,102.44, determined as follows (R. 41–42):

Overstatement of two items: (1) $47,461.37 representing over-valuation of Liberty bonds turned over to the taxpayer by the Receiver in 1920; and (2) $159,751.56 representing proceeds from the sale of oil produced prior to March 11, 1914, together with interest during the years 1914 to 1919, inclusive, under certain agreements with the Standard Oil Company.

Understatement of two items: (1) $40,683 representing capital expenditures in connection with litigation which were erroneously allowed as de-

ductions; and (2) $126,427.49 representing the depletion deduction allowed by the Commissioner on oil and gas produced prior to April 20, 1920.

The District Court concluded that it had jurisdiction of the subject matter of this action to the extent of determining the correct amount of income tax, even though the profits taxes of the taxpayer for the calendar year 1920 had been determined under the special assessment provisions of the 1918 Act (R. 41). The tax on the net income found to be overstated was found to be $4,010.24, and the District Court entered judgment against petitioner accordingly (R. 44–45). On appeal, the Circuit Court of Appeals sustained the District Court.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the District Court had jurisdiction of the subject matter of this action to the extent of revising the taxpayer's net income after it had been determined by the Commissioner for the purpose of computing the profits taxes as provided in Sections 327 and 328 of the Revenue Act of 1918.

2. In entering judgment for the taxpayer.

REASONS FOR GRANTING THE WRIT

Taxpayer here has invoked the discretionary jurisdiction of the Commissioner pursuant to Sections 327 and 328 of the Revenue Act of 1918, al-

leging an abnormal condition affecting income for the year 1920. Pursuant to those sections the privilege of a special assessment was granted to taxpayer after the amount of net income had been agreed upon. By that agreement, the taxpayer abandoned the position that there had been any error of law or of fact in the determination of net income, and is now estopped from retracting its assent and resuming the abandoned ground.

The decision of the court below to the contrary is in conflict with *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73; *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502; *Cleveland Automobile Co.* v. *United States*, 70 F. (2d) 365 (C. C. A. 6th), certiorari denied, 293 U. S. 563; and *Michigan Iron & Land Co.* v. *United States*, 10 F. Supp. 563 (C. Cls.). In the last case the Court of Claims stated (p. 570):

> As a result of the granting of special assessment, the plaintiff's taxes were reduced from $462,000 to $116,000. No appeal was taken to the Board of Tax Appeals from that determination, and the taxes were assessed and paid. It is now proposed by the plaintiff that this court set aside this discretionary act of the Commissioner and find a different value for the timberlands as of March 1, 1913. This would entail going into one of the factors which entered into the exercise by the Commissioner of his discretionary power. In *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, 507, 53 S. Ct. 413, 415, 77 L. Ed. 921, the Supreme Court holds:

> "It is beyond the power of a court to usurp the Commissioner's function of finding that special assessment should be accorded, and equally so to substitute its discretion for his as to the factors to be used in computing the tax."

See also *Central Iron & Steel Co.* v. *United States,* 6 F. Supp. 115 (C. Cls.), certiorari denied, 293 U. S. 563; *W. H. Bradford & Co.* v. *United States,* 6 F. Supp. 117 (C. Cls.); *Con P. Curran Printing Co.* v. *United States,* 14 F. Supp. 638 (C. Cls.)

The amount of taxpayer's net income is one of the essential factors in determining the necessity and extent of relief under Sections 327 and 328. *Heiner* v. *Diamond Alkali Co.,* 288 U. S. 502. Modification of this factor after the Commissioner has granted a special assessment amounts to an abrogation of the Commissioner's administrative discretion in the computation of profits taxes, and defeats the very purpose for which the special provisions were enacted. *Cleveland Automobile Co.* v. *United States,* 70 F. (2d) 365 (C. C. A. 6th), certiorari denied, 293 U. S. 563. Indeed, to protect the revenues, the Commissioner, unless barred by the statute of limitations, would be obligated to make a recomputation or even a complete reexamination of the taxpayer's position, which might result in a denial of relief under the special assessment sections. This obligation placed by the court below upon the Commissioner plainly nullifies

his discretion, contrary to repeated decisions of this Court. *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502; *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73.

CONCLUSION

The court below has failed to apply principles found in the decisions of this Court which we believe to be controlling and has decided a question in a way which is in direct conflict with decisions of other Circuit Courts of Appeals and the Court of Claims.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted, limited to the question of the jurisdiction of the District Court.

STANLEY REED,
Solicitor General.

DECEMBER 1936.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1093:

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit

upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations

prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

U. S. GOVERNMENT PRINTING OFFICE: 1938

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Specification of errors to be urged	4
Summary of argument	4
Argument	5
Conclusion	11
Appendix	12

CITATIONS

Cases:	
Bemis Bro. Bag Co. v. *United States*, 289 U. S. 28	11
Bradford, W. H., & Co. v. *United States*, 6 F. Supp. 117	8
Central Iron & Steel Co. v. *United States*, 6 F. Supp. 115, certiorari denied, 293 U. S. 563	8, 9
Cleveland Automobile Co. v. *United States*, 70 F. (2d) 365, certiorari denied, 293 U. S. 563	7
Continental Products Co. v. *Commissioner*, 66 F. (2d) 434	10
Heiner v. *Diamond Alkali Co.*, 288 U. S. 502	6, 8
Michigan Iron & Land Co. v. *United States*, 10 F. Supp. 563	9
Newaygo Portland Cement Co. v. *Helvering*, 77 F. (2d) 536	10
United States v. *Henry Prentiss & Co.*, 288 U. S. 73	9, 10
United States v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189	10
Welch v. *St. Helens Petroleum Co.*, 78 F. (2d) 631	10
Williamsport Wire Rope Co. v. *United States*, 277 U. S. 551	7
Statute:	
Revenue Act of 1918, c. 18, 40 Stat. 1057:	
Sec. 236	12
Sec. 320	12
Sec. 327	12
Sec. 328	13

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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 602

GALEN H. WELCH, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE SIXTH COLLECTION DISTRICT OF CALIFORNIA, PETITIONER

v.

OBISPO OIL COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The first opinion of the District Court of the United States for the Southern District of California is reported in 48 F. (2d) 872; the second (R. 12–23) is not reported. The majority and dissenting opinions in the Circuit Court of Appeals (R. 35–40) are reported in 85 F. (2d) 860.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 28, 1936 (R. 40). The petition for certiorari was filed December 28, 1936, and was granted February 8, 1937. The jurisdic-

tion of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

After the Commissioner of Internal Revenue has granted a special assessment of profits taxes, pursuant to Sections 327 and 328 of the Revenue Act of 1918, may a court, in an action for refund of income taxes, revise the Commissioner's determination of the taxpayer's net income?

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 12–14.

STATEMENT

The District Court made special findings of fact (R. 12–21). Those pertinent to the question here involved may be summarized as follows:

Pursuant to Sections 327 and 328 of the Revenue Act of 1918, the Commissioner of Internal Revenue determined the profits taxes of the taxpayer for the calendar year 1920 to be $142,765.73, or 9.67% of its net income (R. 21). The taxpayer's income tax for the same year was determined by the Commissioner as follows (R. 21):

Net income		$1,476,330.52
Less:		
Profits tax, Section 328	$142,765.73	
Interest on U. S. obligations not exempt	86,134.16	
Exemption	2,000.00	
		230,899.89
Balance subject to 10% tax		1,245,430.63
Amount of tax at 10%		124,543.06

Thereafter, on December 6, 1927, the taxpayer filed a claim for refund, setting up several grounds for recovery. (R. 18–19.) The claim was rejected on or about February 14, 1928, and the taxpayer filed its original complaint in the District Court on December 2, 1928. (R. 19.)

The District Court found that the Commissioner had overstated the net income by $40,102.44, determined as follows (R. 21–22):

Overstatement of two items: (1) $47,461.37 representing over-valuation of Liberty bonds turned over to the taxpayer by the Receiver in 1920; and (2) $159,751.56, representing proceeds from the sale of oil produced prior to March 11, 1914, together with interest during the years 1914 to 1919, inclusive, under certain agreements with the Standard Oil Company.

Understatement of two items: (1) $40,683, representing capital expenditures in connection with litigation which were erroneously allowed as deductions; and (2) $126,427.49, representing the depletion deduction allowed by the Commissioner on oil and gas produced prior to April 20, 1920.

The District Court concluded that it had jurisdiction of the subject matter of this action to the extent of determining the correct amount of income tax, even though the profits taxes of the taxpayer for the calendar year 1920 had been determined under the special assessment provisions of the 1918 Act. (R. 21.) The tax on the net income found

to be overstated was found to be $4,010.24, and the District Court entered judgment against petitioner accordingly. (R. 23.) On appeal, the Circuit Court of Appeals sustained the District Court.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the District Court had jurisdiction of the subject matter of this action to the extent of revising the taxpayer's net income after it had been determined by the Commissioner for the purpose of computing the profits taxes as provided in Sections 327 and 328 of the Revenue Act of 1918.

2. In entering judgment for the taxpayer.

SUMMARY OF ARGUMENT

The decisions of this Court have denied to the courts the power to substitute their discretion for the Commissioner's as to the factors to be used in computing the tax under Sections 327 and 328 of the Revenue Act of 1918. The courts below, however, revised one of those factors, the net income, not, it is true, for profits tax purposes but only for income tax purposes. It is submitted that a power to revise the net income for income tax purposes in such cases, if lodged in the courts, would directly affect the conclusion reached by the Commissioner in the determination of the profits taxes, necessitating a reexamination to determine whether the revision has removed the abnormality.

If it has not, a search for other representative corporations similarly circumstanced might be required, in which case a different profits tax rate would be applied to the new net income. The result would be to nullify the denial to the courts of the power to invade the discretionary field confided to the Commissioner. An application for special assessment under Section 327 (d) assumes adherence to the statute in the determination of both net income and invested capital and constitutes an abandonment of the right to have the tax computed in accordance with the normal method. Consequently, questions relating to the determination of net income are no longer justiciable.

ARGUMENT

The Revenue Act of 1918, which applies to the year 1920, the year here involved, imposed an excess profits tax at high rates. Because such a tax might, in particular circumstances, become unduly burdensome, Congress provided that in certain situations the tax should be computed in a special manner. This alternative method of assessment, which is provided for by Sections 327 and 328, *infra*, pp. 12, 13, is known as a special assessment.

Subdivision (d) of Section 327, which was here applied,[1] is dependent upon the request of the taxpayer. Pursuant to such a request by respondent,

[1] In its brief opposing the granting of a writ of certiorari respondent contended that the record did not reveal whether the special assessment was made pursuant to subsection (d) of Section 327, which requires an application

its profits tax was computed under the special assessment provisions because certain abnormal conditions had affected its income for that year (R. 4). Notwithstanding this fact, respondent now seeks in this proceeding to have the computation of its income—the factor upon which the special assessment was based—reviewed by the courts and adjudged to be less than the figure employed by the Commissioner in giving respondent the benefit of Sections 327 and 328.

This Court, in *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, has decided that where a taxpayer's *profits taxes* have been settled by the Commissioner under Sections 327 and 328, a court may not revise that computation by a revision of the factors which entered into that computation. We submit that the same result should follow in a suit for refund of *income taxes*, particularly when the abnormality of the income is the very fact which caused the Commissioner to exercise his discretion under the special assessment provisions.

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by the taxpayer, or under subsection (a), (b) or (c), all of which are mandatory upon the Commissioner (Br. pp. 4–5). Respondent's amended complaint, however, alleges that Sections 327 and 328 were applied "due to the abnormality resulting from the inclusion in plaintiff's income for that year [1920] of said impounded funds" (R. 4). Further, respondent alleged that if the impounded funds were eliminated from its income for the year 1920, the application of Sections 327 and 328 would no longer be necessary (R. 5). Obviously, abnormal income is a condition warranting relief only under Section 327 (d), and it is that subdivision which must have been applied.

To deny to the courts the power to review the elements considered by the Commissioner in the determination of the profits taxes under the special assessment provisions but to permit, for purposes of the income tax, judicial revision of an indispensable and often controlling factor in the computation under the relief provisions would bring about a most incongruous situation. It would permit the use of one net income for income taxes under Title II and another net income for profits taxes under Title III, though Section 320 (a) (3) of the Revenue Act of 1918 provides for the same net income under both titles. Furthermore, it would seem to be a contradiction in terms to say that a determination to grant or deny extraordinary relief is not open to judicial review and yet to say that the factors entering into the determination of the tax under the relief provisions may be reviewed. *Cf. Williamsport Wire Rope Co.* v. *United States,* 277 U. S. 551. If considerations affecting net income are to remain open to review, the very basis upon which special assessment can be granted and made becomes a shifting one and the assessment an idle gesture, binding the Government possibly but never the taxpayer. *Cleveland Automobile Co.* v. *United States,* 70 F. (2d) 365 (C. C. A. 6th), certiorari denied, 293 U. S. 563.

The practical effect of the decision below is to give to the courts the power to revise or alter factors entering into the determination of the profits taxes under Sections 327 and 328, and place

upon the Commissioner the obligation to revise his computations under the relief provisions. In the instant case an abnormality affecting income was successfully urged as the ground for the exercise of the Commissioner's discretionary jurisdiction. The judicial revision of income may have removed the very abnormality which produced the asserted hardship and which persuaded the Commissioner to grant extraordinary relief. Certainly, a revised net income would require a reexamination of the comparatives used and possibly compel a search for representative concerns similarly circumstanced different from those previously used. See *Heiner* v. *Diamond Alkali Co., supra,* at p. 507. Necessarily the profits tax rate applicable to the new net income would be corrected. *Central Iron & Steel Co.* v. *United States,* 6 F. Supp. 115 (C. Cls.), certiorari denied, 293 U. S. 563; *W. H. Bradford & Co.* v. *United States,* 6 F. Supp. 117 (C. Cls.). It seems plain, in other words, that a denial of judicial review of the factors which enter into a computation under the relief sections for the purpose of the profits tax only would be no denial at all. Revision of net income by the courts would entail revision by the Commissioner of rates, comparatives and the profits tax itself. Any revision of the profits tax would in turn be reflected in the income tax, because the amount of the former is a credit against the latter under Section 236 (c). The duty to protect the revenues would require the

Commissioner to reopen the case and to reconsider his previous determination. Since the courts are precluded from themselves making these revisions and are equally without authority to remand cases to the Commissioner for his further consideration in the light of a new computation of income, judicially determined, it is clear that the whole matter of the taxpayer's income and profits taxes does not lend itself to judicial review after the taxpayer has, of its own motion, invoked the administrative alternative provided by the statute. *Central Iron & Steel Co.* v. *United States, supra,* at p. 116.

Once a taxpayer has applied for and been granted the extraordinary relief afforded by Sections 327 and 328, he has, by his own act, removed himself from judicial relief. *Michigan Iron & Land Co.* v. *United States,* 10 F. Supp. 563 (C. Cls.). He surrenders the right further to contest in court the correctness of the Commissioner's determination with respect to any of the factors necessary to his discretionary findings and the computation of the tax. *Central Iron & Steel Co.* v. *United States, supra; United States* v. *Henry Prentiss & Co.,* 288 U. S. 73.

In the *Prentiss* case, the Commissioner sent out the usual notice that unless the taxpayer acquiesced in the net income and invested capital no consideration would be given to the application for special assessment. The evidence does not disclose an ac-

quiescence, but this Court said (pp. 87–88) that the taxpayer's conduct in proceeding with its application for a special assessment "was a tacit assent to the condition imposed by the Commissioner and an abandonment of any objection that capital and income had been erroneously valued if valuation was to be ascertained according to the normal method". It is pointed out (288 U. S. at 88) that there is room for argument that the taxpayer, having won the privilege of a hearing on those terms, is estopped from retracting its assent and resuming the abandoned ground. That observation is particularly relevant here for at least two reasons. One is that not only did the taxpayer win the privilege of a hearing, but it actually received the benefits of a special assessment. The other is that retraction, if permitted, would enable it to retain such benefits while the Commissioner would be barred by the statute of limitation, if not by the principles of *res judicata*, from asserting a deficiency in tax which would obviously be due as a result of the changed net income. *Cf. Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434 (C. C. A. 1st); *Newaygo Portland Cement Co.* v. *Helvering*, 77 F. (2d) 536 (App. D. C.).

The question here involved, though present in *United States* v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189, was not submitted to the Court for decision. The case of *Welch* v. *St. Helens Petroleum Co.*, 78 F. (2d) 631 (C. C. A. 9th), is distinguishable. There the taxpayer was a foreign

corporation, and Section 327 (b) requires that the profits tax be determined as provided in Section 328. The ground for relief covered by Section 327 (d) is obviously not the same as the ground in Section 327 (b). Cf. *Bemis Bro. Bag Co.* v. *United States,* 289 U. S. 28. Under Section 327 (b) there could be no abandonment of one method for another, since but one method is provided for.

CONCLUSION

The decision below is erroneous and should be reversed.

Respectfully submitted,

STANLEY REED,
Solicitor General.
JAMES W. MORRIS,
Assistant Attorney General.
SEWALL KEY,
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Special Assistants to the Attorney General.
CHARLES A. HORSKY,
Attorney.

FEBRUARY, 1937.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057:

SEC. 236. That for the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

* * * * *

(c) In the case of a domestic corporation, $2,000.

SEC. 320. (a) That for the purpose of this title the net income of a corporation shall be ascertained and returned—

* * * * *

(3) For the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined

without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

SEC. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily

determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

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U. S. GOVERNMENT PRINTING OFFICE: 1937

No. 602

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

GALEN H. WELCH, Former Collector of Internal Revenue For the Sixth Collection District of California, *Petitioner*,

v.

OBISPO OIL COMPANY, a Corporation.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

Table of Contents.

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement	2, 3
Argument	3-10
1. Question Not Raised Below	3, 4
2. No Basis for Estoppel	4, 5
3. No Conflict With Other Appellate Decisions	5-8
4. Question Not of General Importance	8
5. Court's Reasoning Sound	8-10
Conclusion	10
Appendix	11-14

Table of Cases.

Bemis Bros. Bag Co. v. United States, 289 U. S. 28	5, 6
Cleveland Automobile Co. v. United States, 70 F. (2d) 365	7
General Utilities & Operating Co. v. Helvering, 296 U. S. 200	4
Heiner v. Diamond Alkali Co., 288 U. S. 502	5, 6, 7
Helvering v. Salvage, 297 U. S. 106	4
McKeever v. Eaton, 6 F. Supp. 697	8
Supplee-Biddle Hardware Co. v. United States, 58 Ct. Clms. 343, affirmed 265 U. S. 189	7
United States v. Henry Prentiss & Co., 288 U. S. 73	5, 6
United States v. Supplee-Biddle Hardware Co., 265 U. S. 189, affirming 58 Ct. Clms. 343	7
Welch v. St. Helens Petroleum Co., 78 F. (2d) 631	8

STATUTES.

Page

Judicial Code, Section 240 (a), as amended by Act of February 13, 1925 2
Revenue Act of 1918, 40 Stat. 1057, Section 236 (b) .. 9, 11
Section 239 ..... 9, 11, 12
Section 327 ..... 2, 5, 9, 12
Section 327(a) 5, 12
Section 327(b) 5, 12
Section 327(c) 5, 12
Section 327(d) 5, 7, 12
Section 328 ..... 2, 5, 7, 9, 12-14
Section 336 ..... 9, 14

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 602.

GALEN H. WELCH, Former Collector of Internal Revenue For the Sixth Collection District of California, *Petitioner*,

v.

OBISPO OIL COMPANY, a Corporation.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

OPINIONS BELOW.

The opinion of the District Court of the United States for the Southern District of California (R. 25-43) is not reported. The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 85 F. (2d) 860.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered September 28, 1936. Petition for certiorari was filed December 28, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Did the Circuit Court of Appeals err in affirming a judgment of the District Court to a taxpayer for a refund of income taxes overpaid for the taxable year 1920, where its profits taxes for that year were determined under the provisions of Sections 327 and 328, Revenue Act of 1918?

STATUTE INVOLVED.

The statute involved will be found in the Appendix, *infra*, pp. 11-14.

STATEMENT.

The evidence introduced in the District Court is not included or summarized in the Record before this Court, but it consisted principally of Stipulations and documentary evidence (R. 44). The Record contains the trial court's Findings of Facts (R. 26-41) against which no assignment of error has been made by either party. (R. 50-51; Supp. R. 5-6.) The only findings made by the trial court which bear on the particular question here involved were as follows:

> "The Commissioner of Internal Revenue determined the profits taxes of Plaintiff for the calendar year 1920 under the provisions of Sections 327 and 328, Revenue Act of 1918, in the total amount of $142,765.73, or at the rate of 9.67 per cent of Plaintiff's income, subject to profits tax, of $1,476,330.52 for that year. The Commissioner determined the income tax of Plaintiff for 1920 as follows:

Net Income—		$1,476,330.52
Less:		
Profits tax, Section 328—	$142,765.73	
Interest on U. S. obligations not exempt—	86,134.16	
Exemption—	2,000.00	230,899.89
Balance subject to 10% tax—		$1,245,430.63
Amount of tax at 10%— (R. 40).		124,543.06''

The District Court found that the Commissioner had overstated the net income subject to income tax by $40,102.44, and rendered a judgment for the refund of income taxes overpaid in the amount of $4,010.24 (R. 42). No adjustment was made in the profits tax computation of the Commissioner. The Circuit Court of Appeals sustained the District Court (Supp. R. 18).

ARGUMENT.

Petitioner's argument is grounded upon some theory of estoppel to prevent respondent from recovering income taxes which both the lower courts have determined to have been overpaid and refundable. Respondent submits that since petitioner did not raise this point below, it is not properly before the court as a question in this case.

1. *Question Not Raised Below.* In the first place, this contention was not raised in either of the courts below. Neither in the Answer to Amended Complaint (R. 14-21) nor in the Motion for Judgment (R. 23) did defendant in the District Court plead estoppel or allege any facts to support such a claim. Likewise the Findings of Fact and Conclusions of Law made by the District Court fail to disclose that any such issue was raised (R. 25-43). Furthermore, petitioner's assignments of error upon appeal to the Circuit Court of Appeals are absolutely silent on any issue of estoppel (Supp. R. 5-6).

In the absence of such a contention before the courts below, petitioner's plea of estoppel should not be considered by this Court. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206; *Helvering* v. *Salvage*, 297 U. S. 106, 109. In the latter case, the Supreme Court stated (p. 109):

> "The defense of estoppel was not before the Board. Under what we regard as the correct practice, General Utilities & Operating Co. v. Helvering, * * * the court should have passed the point. Furthermore, the facts disclosed give it no support."

In *General Utilities & Operating Co.* v. *Helvering, supra*, the Supreme Court stated (p. 206):

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised."

2. *No Basis For Estoppel.* Furthermore, there is absolutely no basis in the Record before this court for the statements made in petitioner's brief purporting to set forth facts supporting the claim of estoppel.* In substance, petitioner states (a) that special assessment of profits taxes was granted the taxpayer as a *privilege* by the Commissioner, and (b) that the privilege was granted only after

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* On pages 4 and 5, under "Reasons for Granting the Writ," counsel for petitioner make the following statements:

> "Taxpayer here has invoked the discretionary jurisdiction of the Commissioner pursuant to Sections 327 and 328 of the Revenue Act of 1918, alleging an abnormal condition affecting income for the year 1920. Pursuant to those sections the privilege of a special assessment was granted to taxpayer after the amount of net income had been agreed upon. By that agreement, the taxpayer abandoned the position that there had been any error of law or of fact in the determination of net income, and is now estopped from retracting its assent and resuming the abandoned ground."

the taxpayer had *agreed upon* the net income. Counsel fail to cite any evidence or findings in the Record to support these alleged statements of facts—none could be found.

Reference to the provisions of Section 327, Revenue Act of 1918, set forth in the Appendix hereto, will disclose that special assessment of the profits tax under Section 328 is appropriate under four situations, of which the first three, subsections (a), (b) and (c), are mandatory and only one, subsection (d), lies within the discretionary power of the Commissioner. See *Bemis Bros. Bag Co.* v. *United States*, 289 U. S. 28. Obviously, petitioner's statement that "taxpayer here has invoked the discretionary jurisdiction of the Commissioner" would be true if, and only if, the determination was made under subsection (d) of Section 327.

However, the Record is absolutely silent on this point. The District Court found merely that the profits taxes were determined "under the provisions of Sections 327 and 328, Revenue Act of 1918." (R. 40). Even petitioner's assignment of errors in the court below merely contended that the tax was determined and assessed "under the special assessment provisions of Sections 327 and 328." (Supp. R. 5). Nowhere in the Record will be found any evidence that the "privilege of a special assessment was granted" under the "discretionary jurisdiction" set forth in subsection (d), or that taxpayer alleged "an abnormal condition affecting income for the year 1920."

Likewise, there is not a shred of evidence anywhere in the Record to support petitioner's statement that the taxpayer agreed upon the amount of net income and thereby "abandoned the position that there had been any error of law or of fact in the determination of net income."

3. *No Conflict with Other Appellate Decisions.* Petitioner also contends that the decision of the court below is in conflict with decisions of various other courts. Among the cases so cited are two decisions of this Court, *United States* v. *Henry Prentiss & Co.*, 288 U. S. 73, and *Heiner* v.

Diamond Alkali Co., 288 U. S. 502, neither of which is decisive of the question here presented.

The exact holding in the *Prentiss* case is clearly stated by Mr. Justice Cardozo in *Bemis Bros. Bag Co.* v. *United States*, 289 U. S. 28, at 32, as follows:

> "We held in United States v. Prentiss & Co. supra, that after the period of limitation a claim for a special assessment under § 327 (d) may not be turned by amendment into one for the reaudit of invested capital and for the reassessment of the tax accordingly."

No such question is presented in the present case. The original claim for refund raised the issues regarding the computation of net income, and no amendment is relied upon. Likewise no question of limitations is here involved.

In *Heiner* v. *Diamond Alkali Co., supra*, the lower court held that the Commissioner's determination of net income was erroneous, applied the special assessment profits tax rate to the revised net income, and determined *refunds of both profits tax and income tax* for the year in question. The Government did not claim any error with respect to the *income tax refund*, but obtained a review by the Supreme Court of the judgment with respect to the *profits tax* determination.* The Supreme Court there held that the *profits tax* determination by the Commissioner under special assessment was conclusive upon the court and that the amount of the profits tax could not be changed even though the court determined that the net income was overstated, but did not change or question the lower court's allowance of a refund based solely upon the *income tax* computation.

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* On page 12 of the Solicitor General's brief before the Supreme Court in that case the following statement appears:

> "Petitioners do not question here the action of the courts below in reducing the *normal income tax* by increasing the deductions from gross income and applying to the reduced net income the normal tax rate prescribed by the statute. The questions presented to this Court in the instant case relate only to *profits taxes*. Attention, however, is called to the fact that there is a necessary correlation between the profits tax and the income tax since, under Sec. 236(b) of the statute, the amount of the former is allowed as a credit against net income in computing the latter."

In the present case, respondent claims and the courts below have allowed *only* the reduction in *normal income tax* to which it is justly entitled on the basis of the correct net income; the Commissioner's computation of the *profits tax* is not changed or affected to any extent whatever. This is exactly the effect of the final decision in the *Diamond Alkali Co.* case, and the effect of the only other decision of an appellate court cited in petitioner's brief, *Cleveland Automobile Co.* v. *United States,* 70 F. (2d) 365 (CCA-6th). An examination of that Court's opinion indicates that the issue considered was the power of the courts to revise the *profits tax* determined under Sections 327(d) and 328. The Court did not consider at all the *income tax* question here presented, probably because the Court *held that the Commissioner had properly determined the taxable net income.* Clearly that decision is entirely consistent with the decision of the courts below in the instant case.

The Court of Claims, in *Supplee-Biddle Hardware Co.* v. *United States,* 58 Ct. Clms. 343, assumed jurisdiction of a case in which the profits tax had been determined under special assessment and rendered a judgment for refunds of both profits tax and income tax. Yet in that case, the refund was based upon an error in the Commissioner's determination of net income.

Upon appeal, the judgment of the Court of Claims was affirmed by the Supreme Court, its opinion being reported in *United States* v. *Supplee-Biddle Hardware Co.,* 265 U. S. 189. The Supreme Court expressly noted in its opinion that:

> "The Commissioner of Internal Revenue reduced this amount by $29,584.06, in accordance with the powers conferred upon him by §§ 327 and 328 of the Revenue Act of 1918, to reduce the rate of taxation in cases of unusual hardship."

Notwithstanding this fact, the Supreme Court held the Commissioner had made an erroneous determination of net

income and that the taxpayer could recover both profits taxes and income taxes overpaid. See also *McKeever* v. *Eaton*, 6 F. Supp. 697 (D. C., D. Conn.).

These decisions demonstrate that the courts have *jurisdiction* to review the Commissioner's determination of income and profits taxes, even where the latter have been determined under special assessment; the limitation is merely upon the power of the courts to revise certain determinations made by the Commissioner under discretionary powers granted by Congress, in connection solely with the *profits tax*.

The only pertinent issue raised in the Assignment of Errors below (Supp. R. 5) was based upon the contention "that the Court has no jurisdiction over the subject matter of this action."

The decision of the court below is supported by the prior decision of the same court in *Welch* v. *St. Helens Petroleum Co.*, 78 F. (2d) 631, from which no appeal was taken by the Government.

4. *Question Not of General Importance.* The Revenue Act of 1921 was the last act to provide for excess profits taxes based upon "invested capital" and "special assessment" and 1921 was the last taxable year to which these provisions were applicable. Accordingly, it is now almost fifteen years since the latest returns were filed which could involve the question here considered. Obviously, it would be a very exceptional case in which the statute of limitations would not have run against both the Government and the taxpayer. Therefore, this issue could not possibly be of general importance and, in fact, it is doubtful whether any other case would be affected by a decision of the Supreme Court in this case.

5. *Court's Reasoning Sound.* The reasoning of the court below on this question is full, well-considered, and sound. As there stated, the profits tax is provided for in Title III of the Act, which is complete in itself and entirely separate from Title II which provides for the income tax. There

are separate provisions in the two titles for returns, in Sections 239 and 336. As a matter of fact the "net income" for purposes of the income tax is materially different from the "net income" determined for purposes of the profits tax.

The mere fact that a deduction of the profits tax is allowed in determining the net income subject to the income tax is not important; similar deductions were allowed for property taxes, franchise taxes, and State income taxes. Section 236(b) provides for the deduction of "the amount of any taxes imposed by Title III for the same taxable year." The only test is the *amount* imposed and it is immaterial *how* it was determined.*

This is a case in which the Commissioner, as held by the courts, made an erroneous determination of net income—a determination involving no discretion. The petitioner's argument that this error must stand uncorrected (merely because the taxpayer was entitled to and received treatment under Sections 327 and 328 as to its profits tax) imputes to Congress an unreasonable intention.

If in this case the Commissioner's overstatement of net income cannot be reviewed and corrected at the taxpayer's instance, it is unique in the system of corrective justice set up by the tax laws.

Far from being inconsistent with the decisions of the Supreme Court, the decision and opinion of the court below carry out both the letter and the spirit of the principles laid down by this Court. The profits tax determination by the Commissioner under Title III was not altered or questioned in any respect; on the contrary, the amount so determined was followed exactly in computing the net income subject to the income tax.

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* Examination of the Revenue Act of 1918 discloses that with the exception of Titles I, XIII and XIV, which contain "General Provisions", each of the other eleven titles covers a different form of tax, and that they are mutually independent. There would appear to be no reason why the method of computation of the tax imposed under one title should preclude the review and revision of the tax imposed under any other title.

The court below, while giving full faith and credit to the Commissioner's determination of the profits tax, has determined errors made in the computation of income for purposes of the separate and distinct income tax. Congress provided that this tax should be at the fixed rate of 10 per cent upon net income determined in accordance with the provisions of Title II and has left no discretion to the Commissioner in this respect. The court below has merely applied this fixed rate to the correct net income, so determined.

CONCLUSION.

The court below has correctly applied the law in accordance with the principles found in the decisions of this Court, and there is no sound reason of law, equity or policy why its judgment should be reviewed or changed.

WHEREFORE, it is respectfully submitted that the petition for a writ of certiorari should not be granted.

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APPENDIX.

Revenue Act of 1918, 40 Stat. 1057:

Title II—Income Tax

CREDITS ALLOWED.

Sec. 236. • • •

(b) The amount of any taxes imposed by Title III for the same taxable year: *Provided*, That in the case of a corporation which makes return for a fiscal year beginning in 1917 and ending in 1918, in computing the tax as provided in subdivision (a) of section 205, the tax computed for the entire period under Title II of the Revenue Act of 1917 shall be credited against the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, and the tax computed for the entire period under Title III of this Act at the rates prescribed for the calendar year 1918 shall be credited against the net income computed for the entire period under this title;

CORPORATION RETURNS.

Sec. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228. When return is made

under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

Revenue Act of 1918, 40 Stat. 1057:

Title III—War-Profits and Excess-Profits Tax

Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

Sec. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemp-

tion of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to

such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

Sec. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

No. 602

FILE
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CHARLES ELMOR

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

GALEN H. WELCH, Former Collector of Internal Revenue For the Sixth Collection District of California, *Petitioner,*

v.

OBISPO OIL COMPANY, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

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INDEX

Table of Contents

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement	2
Summary of Argument	5
Argument	7
Decisions of this Court	11
Conclusion	16
Appendix	17

Table of Cases

Austin Company v. Commissioner, 35 F. (2d) 910	15
Bemis Bros. Bag Co. v. United States, 289 U. S. 28	12
Botany Worsted Mills v. United States, 278 U. S. 282	15
General Utilities and Operating Co. v. Helvering, 296 U. S. 200	15
Heiner v. Diamond Alkali Co., 288 U. S. 502	12
Helvering v. Salvage, 297 U. S. 106	15
North American Oil Consolidated v. Burnet, 286 U. S. 417	4
Oak Worsted Mills v. Commissioner, 38 F. (2d) 699	15
United States v. Factors & Finance Co., 288 U. S. 99	13
United States v. Felt & Tarrant Mfg. Co., 283 U. S. 269	13
United States v. Henry Prentiss & Co., Inc., 288 U. S. 73	11
United States v. Supplee-Biddle Hardware Co., 265 U. S. 189	13
Welch v. St. Helen's Petroleum Co., 78 F. (2d) 631	9
Williamsport Wire Rope Co. v. United States, 277 U. S. 551	11

STATUTES

	Page
Judicial Code, Section 240 (a), as amended by the Act of February 13, 1925	2
Revenue Act of 1917, Section 210	13
Revenue Act of 1918, Section 230	17
Section 232	17
Section 236	17
Section 236 (b)	17
Section 239	17
Section 320	19
Section 327	19
Section 327 (a)	19
Section 327 (b)	19
Section 327 (c)	19
Section 327 (d)	19
Section 328	20

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The first opinion of the District Court of the United States for the Southern District of California is reported in 48 F. (2d) 872; the second (R. 12-23) is not reported. The majority and dissenting opinions[1] of the Circuit Court of Appeals (R. 35-40) are reported in 85 F. (2d) 860.

[1] The dissenting opinion relates solely to a depletion question which is not in issue before this Court.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered September 28, 1936 (R. 40). The petition for certiorari was filed December 28, 1936, and was granted February 8, 1937. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Did the courts below err in correcting errors in the determination of net income and in ordering a refund of *income tax* for 1920, where the *profits tax* for that year was determined under Sections 327 and 328, Revenue Act of 1918?

STATUTE INVOLVED.

The statutory provisions involved are set forth in the Appendix, *infra*, pp. 17-21.

STATEMENT.

The evidence introduced in the District Court is not included nor summarized in the Record before this Court, but it consisted principally of written stipulations and documentary evidence (R. 23). The Record contains the District Court's Findings of Fact (R. 12-21) concerning which no assignment of error has been made by either party (R. 26-27; 30-31). The only findings made by the trial court which bear on the question of special assessment here involved were as follows (R. 21):

> "The Commissioner of Internal Revenue determined the profits taxes of Plaintiff for the calendar year 1920 under the provisions of Sections 327 and 328, Revenue Act of 1918, in the total amount of $142,765.73, or at the rate of 9.67 per cent of Plaintiff's income, subject to profits tax, of $1,476,330.52 for that year. The Commissioner determined the income tax of Plaintiff for 1920 as follows:

Net income		$1,476,330.52
Less:		
Profits tax, Section 328...	$142,765.73	
Interest on U. S. obligations not exempt.....	86,134.16	
Exemption	2,000.00	230,899.89
Balance subject to 10% tax.....		$1,245,430.63
Amount of tax at 10%		124,543.06."

In the courts below the foregoing determination by the Commissioner of "net income" in the sum of $1,476,330.52 was held to be erroneously high, and the courts' finding as to such errors of the Commissioner in determining net income is not challenged by either party before this Court. The controversy in this Court relates entirely to the "credit" of $142,765.73 which the Commissioner allowed, as above shown, and which the courts have treated as allowable in this case. This credit is claimed by respondent and was allowed by the Commissioner and by the courts under Section 236, Revenue Act of 1918, which in effect provides that after the determination of net income and before the application of the income tax rate, there shall be allowed three types of credits: (a) certain interest on obligations of the United States and on War Finance Corporation bonds; (b) taxes imposed by Title III of the Revenue Act of 1918 (profits taxes); and (c) a specific credit of $2,000.00.

Other pertinent findings of fact may be summarized briefly as follows:

During the period from March 11, 1914 to November 29, 1920, respondent was engaged in litigation with the United States Government concerning its right, title and interest in certain oil lands in California (R. 14, 17). Throughout said period a receiver appointed by the District Court was in charge of the property with direction to impound the proceeds therefrom pending termination of the litigation (R. 14). During 1920, the litigation was settled in accordance with an act of Congress (R. 16-17). Pursuant to said

settlement, respondent paid certain amounts and delivered a quit-claim deed to the United States Government, and in return received a lease from the Government, together with a release of all the impounded funds (R. 16-17). The Commissioner of Internal Revenue held that said released funds, after certain depletion deductions, constituted taxable income of respondent for 1920, increased the taxable net income by $1,378,077.32, and assessed and collected additional income and profits taxes thereon (R. 17-18).

Thereafter respondent filed in the manner provided by law a claim for refund of the additional taxes so determined and paid, setting forth several grounds for recovery (R. 18-19). The claim was rejected by the Commissioner of Internal Revenue and in due course the complaint in the present suit was filed (R. 19).

At the first trial the District Court entered judgment for respondent herein in the full amount claimed, on the ground that the impounded funds constituted taxable income for the various years in which they were produced. An appeal was taken by petitioner herein to the Circuit Court of Appeals for the Ninth Circuit. Thereafter this Court handed down its decision in *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417. Counsel for both parties agreed that under said decision of this Court the impounded funds received by the respondent constituted taxable income for the year here in question and that the judgment of the District Court ought to be changed in that respect. Accordingly, the case was referred back to the District Court for correction of the holding on this point and for consideration of other issues.

The District Court found that respondent's net income as determined by the Commissioner was excessive in the net amount of $40,102.44, based on various overstatements and understatements, of items connected with the litigation referred to (R. 22). The District Court determined that it had jurisdiction to the extent of determining the correct amount of *income tax* (R. 21), and entered judgment in

favor of respondent in the amount of $4,010.24, representing the income tax at the rate of 10 per cent on the net overstatement of $40,102.44 (R. 22).

Respondent in due course perfected an appeal to the Circuit Court of Appeals based on several assignments of error, including a claim for an additional depletion allowance of $516,598.10 (R. 26-29). Thereafter, petitioner herein perfected a cross-appeal based principally on the contention that the District Court had no jurisdiction over the subject matter of the action[2] (R. 29-33).

The Circuit Court of Appeals held that respondent was entitled to the additional depletion allowance of $516,598.10 claimed by respondent (R. 37-38) and also held that the trial court had jurisdiction to redetermine the income tax on the basis of the corrected net income (R. 39). The total of the adjustments by the District Court ($40,102.44) and by the Circuit Court of Appeals ($516,598.10) indicated that the Commissioner had overstated net income by $556,700.54.

SUMMARY OF ARGUMENT.

The courts below determined that the Commissioner's computation of respondent's "net income" for purposes of the income tax ($1,476,330.52) was excessive to the extent of $556,700.54. In the determination of said "net income" and in the determination of the income tax at the rate of

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[2] The exact language of the assignment of error was as follows (R. 30):

> "The Court erred in rendering judgment against the Defendant and in favor of the plaintiff herein for the reason that the Court has no jurisdiction over the subject matter of this action, the tax sought to be recovered having been determined and assessed by the Commissioner of Internal Revenue of the United States under the special assessment provisions of Sections 327 and 328 of the Revenue Acts of 1918 and 1921 (40 Stat. 1092, 1093)."

This statement that this tax has been determined under the special assessment provisions is incorrect since the "tax sought to be recovered" was an *income tax* (Title II, Revenue Act of 1918) whereas the taxes "determined and assessed by the Commissioner of Internal Revenue of the United States under the special assessment provisions of Sections 327 and 328" (Title III, Revenue Act of 1918) were *profits taxes*.

10 per cent under Title II, Revenue Act of 1918, no discretionary power has been entrusted to the Commissioner. Likewise, no uncertainties or administrative difficulties are involved. Accordingly, a refund of the income taxes so overpaid is proper.

Petitioner contends that errors in the computation of net income may not be corrected for purposes of the *income tax*, this, on the ground that the *profits tax* allowed as a credit thereon was determined by the Commissioner under the special assessment provisions. This contention, if upheld, would penalize petitioner unreasonably, taxing it upon a "net income" admittedly excessive, in the net, by $556,700.54, merely because of a credit claimed, in the lesser amount of $142,765.73. Furthermore, said amount of $142,765.73 is the amount of profits tax actually and finally "imposed by Title III" and, as such, is expressly allowable as a credit. It is immaterial and irrelevant whether the Commissioner, in determining the amount of the profits tax, did so under one or another of the provisions of Title III. The method of determining that tax is not an issue in this case.

Even if in this case the respondent had failed to prove any amount whatever in respect to this credit, this failure to take advantage of a credit allowed for his benefit would not impair his right to have greater errors in the determination of net income corrected, or defeat the jurisdiction of the courts. The credit for excess profits tax could not be less than zero; assuming that figure were found by the Commissioner, or assuming that the respondent waived entirely his right to this credit, the taxpayer is still shown to have made an overpayment of income tax, in a definite and substantial amount.

Congress has expressly provided for only two methods of final determination of the income tax, (1) by formal closing agreements and (2) by accepted offers in compromise. The finality of other determinations is not lightly to be inferred from general provisions of the law. Title II, imposing an income tax, and Title III, imposing a profits tax,

are entirely separate and distinct. The fact that the amount of the profits tax determined under Sections 327 and 328 is not subject to review by the courts fixes with finality the amount deductible as a credit under Section 236.

This Court has recognized in several cases that the courts do not lose jurisdiction of refunds relating to income tax, merely because the profits tax was determined under special assessment. In no case has this Court expressed an opinion that the courts are devoid of such jurisdiction.

ARGUMENT.

The Commissioner of Internal Revenue determined that respondent's "net income" for income tax purposes, before credits and exemptions, was $1,476,330.52. The court below has held that said determination was overstated in the net amount of $556,700.54 because of inclusions of items not taxable as income, together with the exclusion of deductions expressly allowed by the statutory provisions. The court below further held that respondent is entitled to a refund of the income tax, at the fixed statutory rate of 10 per cent, erroneously assessed and collected by reason of said net overstatement of net income.

As shown in the Statement, there is no issue in this case as to the correctness of the foregoing adjustment nor as to the actual finding by the Commissioner that the amount of the credit for profits tax allowable under Section 236(b) is $142,765.73, nor as to any other amount necessary for the calculation of the income tax. The only contention of the petitioner herein, and the only contention open to him in this case, is that merely because the figure of $142,765.73, determined by the Commissioner as the amount of the credit, was determined by him under Sections 327 and 328, the courts are completely without jurisdiction of the subject-matter. Apparently he bases this contention upon the possibility that the Commissioner's determination of that figure is erroneous, although nothing has been proved in

this case by either party which would warrant the courts in refusing to be bound by this official determination.

Under this contention an alleged uncertainty over the amount of a credit of only $142,765.73 would be allowed to prevent the correction of now admitted errors by the Commissioner in the much greater amount of $556,700.54. The very statement of the contention emphasizes its unfairness and illogical character. Even if the Commissioner's determination as to the amount of this credit were disregarded, and the record regarded as failing to support any credit whatever, the overstatement of the income tax would still be apparent.

At the outset, it should be noted that in the Revenue Act of 1918 Congress provided eleven different types of taxes, each under a separate "title."[3] The refund determined by the courts below pertains solely to the tax imposed by Title II, entitled "Income Tax." The profits tax allowed as a credit under Section 236 (b) is that imposed by Title III, entitled "War-Profits and Excess-Profits Tax." Section 327 specifies four types of situations in which the profits tax shall be determined, as provided in Section 328, by comparison with rates paid by representative corporations engaged in a like trade or business. The profits tax of respondent for the taxable year in question was determined under the provisions of Sections 327 and 328, in the amount of $142,765.73.

Under three of the situations prescribed in Section 327, described in subdivisions (a), (b) and (c), special assessment under Section 328 is mandatory upon the Commissioner, while in only one subdivision, (d), is it left to the discretion of the Commissioner. See *Bemis Bros. Bag Co.* v. *United States*, 289 U. S. 28. Petitioner states (Br. 5-6) that special

[3] Examination of the Revenue Act of 1918 discloses that with the exception of Title I, XIII and XIV, which contain "General Provisions", each of the other eleven titles covers a different form of tax, and that they are mutually independent. There would appear to be no reason why Congress should intend that the method of computation of the tax imposed under one title should preclude the review and revision of the tax imposed under any other title.

assessment in the present case was granted under the discretionary powers of the Commissioner under subdivision (d). Respondent takes issue with this statement and submits that it is not substantiated by the record in the case. The finding of the trial court is merely that the profits taxes were determined "under the provisions of Sections 327 and 328, Revenue Act of 1918," without reference to any particular subdivision. (R. 21). If petitioner thought that the evidence in the trial court justified a finding that the Commissioner acted under subdivision (d), he should have requested a finding to that effect. The absence of such a finding or any request therefor indicates that the evidence would not support that finding. That the courts below were justified in assuming jurisdiction if special assessment was founded upon the mandatory subdivisions, apparently is conceded by petitioner (Br. 10-11, citing *Welch* v. *St. Helen's Petroleum Co.*, 78 F. (2d) 631).

However, even if this Court assumes, despite the foregoing that respondent's profits tax for 1920 was determined under special assessment pursuant to the discretionary provisions of subdivision (d), there still is no basis, either in the statute or in equity, for denying jurisdiction in the courts below to order the refund of the entirely distinct income tax illegally collected with respect to admitted overstatements of the statutory "net income."

As shown by the statutory provisions set forth in the Appendix, the income tax imposed by Title II and the profits tax imposed by Title III are separate taxes, the provisions as to each being self-contained. The only way in which the determination of the profits tax imposed by Title III becomes material in determining the income tax imposed by Title II is that the amount of tax imposed by Title III is "allowed" as a credit against the net income determined under Title II, before the tax percentage is applied.

This is not one of the cases in which it is sought to force an unwilling Commissioner to determine the profits tax by invoking any particular method prescribed in Title III, nor

is it a case in which the taxpayer is criticizing or seeking to change a determination made by the Commissioner under Title III. In this case, since the Commissioner determined the profits tax under Sections 327 and 328, he did indeed exercise discretionary powers and the courts below have properly recognized their duty to accept the result of the exercise of such discretion as final. Therefore while in the calculation of the income tax the taxpayer is allowed a credit in an amount equal to the determination which the Commissioner has made, the Commissioner's discretionary powers were exhausted when the profits tax was imposed. That figure being fixed, the calculation of the income tax involves no discretion on his part.

The intention of Congress in allowing credits against the net income before the application of the income tax rates was obviously to benefit the taxpayer and not the Government, since in no event could the allowance of these credits operate to increase the income tax. Therefore it is unreasonable to adopt any construction of the law under which the allowance of the profits tax credit would be considered as so essential an element in the computation of the tax that the taxpayer should be deprived of all other adjustments in the event there is uncertainty as to this particular item. If a taxpayer, for instance, failed to introduce into a record the necessary proof with regard to the credit allowable under the same section for interest on Government obligations, this would not prevent the court from giving him relief from overdeterminations of net income by the Commissioner in other respects. So, here, if there were nothing in the record to show what credit the taxpayer was entitled to in respect to profits taxes, the courts still have full jurisdiction to correct the overstatements of net income and award refunds to that extent. In other words, the severest penalty attached to uncertainty or lack of proof as to the amount of any credit should be the exclusion of such credit, just like any other claimed deduction, in computing the amount of the income tax. In the present case, even if Congress

had not provided any credit whatever for profits taxes, respondent admittedly would be entitled to a substantial refund. Surely Congress did not intend that a credit or deduction provision should deprive the courts entirely of jurisdiction with respect to any phase of income taxes.

Decisions of this Court.

None of the various decisions of this Court cited in petitioner's brief bear out his contention that the courts are without jurisdiction to entertain a suit for the recovery of *income taxes* merely because the *profits taxes* were determined under a special assessment. In *Williamsport Wire Rope Co.* v. *United States*, 277 U. S. 551, this Court held that the Court of Claims could not review a determination by the Commissioner, under the discretionary powers granted in Section 327(d), that the taxpayer was not entitled to special assessment of its profits taxes. After pointing out the administrative difficulties which would be involved in such a review by the courts, this Court said (p. 562):

> "• • • We conclude that the determination whether the taxpayer is entitled to the special assessment was confided by Congress to the Commissioner, and could not, under the Revenue Act of 1918, be challenged in the courts—at least in the absence of fraud or other irregularities."

In that case, no question was raised as to the correctness of the Commissioner's determination of the statutory "net income" or of the income tax thereon, which are the only issues here in question. Furthermore, in the present case, the Commissioner determined the profits tax under a special assessment and neither party to this appeal questions the propriety of such action.

In *United States* v. *Henry Prentiss & Co., Inc.*, 288 U. S. 73, the taxpayer attempted, after expiration of the period within which a claim for refund could be filed, to transform, by amendment, a claim based upon an application for spe-

cial assessment into a claim for revision of the profits tax by increasing the amount fixed for *invested capital*. This Court held that could not be done.[4] In that case no question was raised as to the correctness of the Commissioner's determination of the net income and of the income tax.

In *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, this Court held that the courts could not change the Commissioner's determination of the profits tax under special assessment even if the net income used in such determination was excessive. No issue was raised in that case as to the trial court's revision of the income tax on the basis of the corrected net income.[5] In the present case, the courts below made no change whatever in the Commissioner's determination of the profits tax but adopted it for all purposes.

The above cases are the only decision of this Court cited by petitioner in support of its contentions herein. In each of them the only issue raised related to the determination of the profits tax and in none of them did this Court hold, directly or indirectly, that the Commissioner's determination of the income tax was not subject to review. On the contrary, the Court's decision in the *Diamond Alkali Co.* case, reversing the lower courts' revision of the profits tax with-

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[4] In *Bemis Bros. Bag Co.* v. *United States*, 289 U. S. 28, 32, Mr. Justice Cardozo, who rendered the opinion in the *Prentiss* case, said:

> "We held in United States v. Prentiss & Co., supra, that after the period of limitation a claim for a special assessment under Section 327(d) may not be turned by amendment into one for the reaudit of invested capital and for the reassessment of the tax accordingly."

[5] On page 12 of the Solicitor General's brief before the Supreme Court in that case the following statement appears:

> "Petitioners do not question here the action of the courts below in reducing the *normal income tax* by increasing the deductions from gross income and applying to the reduced net income the normal tax rate prescribed by the statute. The questions presented to this Court in the instant case relate only to *profits taxes*. Attention, however, is called to the fact that there is a necessary correlation between the profits tax and the income tax since, under Sec. 236(b) of the statute, the amount of the former is allowed as a credit against net income in computing the latter."

If this Court had considered that the lower courts were without jurisdiction to review even the computation of income taxes, it presumably would have so held even though that issue was not raised directly on the Government's appeal.

out reversing their revision of the income tax, indicates at least that the courts are not devoid of jurisdiction to review the income tax upon the basis of proved errors in the determination of "net income."

Furthermore, other decisions by this Court recognize that the courts have such jurisdiction. In *U. S.* v. *Factors & Finance Co.*, 288 U. S. 89, decided on the same day as the *Prentiss* case, this Court held that a general claim for refund not specifying grounds might be amended after the period of limitation by claiming a special assessment under Section 210 Revenue Act of 1917. In that case, it is true, the Commissioner had determined a revision of the profits tax under special assessment and the only issue before this Court related to the sufficiency of the amendment to the claim for refund. However, if jurisdiction were lost by the courts wherever a taxpayer makes application for special assessment, as petitioner contends, this Court presumably would have refused to review the matter at all. See also *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S. 269.

In *United States* v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189, this Court affirmed a judgment of the Court of Claims allowing a refund of both income and profits taxes to a taxpayer whose profits tax had been determined under special assessment, where the only issue raised was the correctness of the Commissioner's determination of net income. Petitioner concedes (Br. 10) that the question here involved was present in the *Supplee-Biddle Co.* case, but attempts to distinguish the decision on the ground that this question was not submitted to the Court for decision. However, the fact is that this Court fully understood the situation[6] and if there had been any doubt as to the jurisdiction

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[6] In its opinion, at page 193, this Court said:

"The Commissioner of Internal Revenue reduced this amount by $29,584.06 in accordance with the powers conferred upon him by Sections 327 and 328 of the Revenue Act of 1918 to reduce the rate of taxation in cases of unusual hardship. There remained, however, the sum of $55,153.89, which tax the appellees paid under protest, and for this with interest, the Court of Claims gave judgment to the appellee."

of the courts, it presumably would have dismissed the case. Accordingly, that decision, which approved a refund of profits taxes as well as income taxes, goes far beyond the action of the courts below in ordering a refund of income taxes only, in the present case.

We respectfully submit that the decisions of this Court do not rest upon the lack of *jurisdiction* in the courts to review cases in which the taxpayer has applied for special assessment, but upon an admitted principle of law that the courts will not revise a determination by the Commissioner of the profits tax under special assessment or review his determination that special assessment should not be applied. In both of these situations the Commissioner has been granted discretionary powers which would be very difficult to review. In view of these administrative difficulties, it is reasonable to assume that Congress did not intend that such decisions should be changed by the courts, in the absence of fraud or other irregularities. Where, however, it is not necessary for the courts to pass upon the propriety of special assessment or to review the actual determination of special assessment, this Court has recognized not only the inherent jurisdiction, but also the power of the courts to review the case and to take appropriate action.

In the present case, no administrative difficulties are involved. Following the decisions of this Court, the courts below have made no change whatever in the profits tax determination by the Commissioner, but on the contrary have treated it as final and not subject to review. Petitioner's objections properly relate only to the propriety of the courts' action in allowing as a credit under Section 236(b) the amount of profits tax actually determined and collected by the Commissioner under the provisions of Title III. We submit that such action was proper, since the profits tax so collected was the amount of taxes actually "imposed by Title III for the same taxable year" and therefore comes within the express provisions of Section 236 (b).

However, if there were any question or uncertainity as to the correct amount of the profits taxes imposed by Title III, we submit that the remedy is to disallow the credit entirely for lack of proof, not to refuse to correct other and larger errors in the computation. This "credit" does not enter into the computation of "net income" but is merely deducted therefrom, along with other credits applied by law, before applying the fixed statutory rate of 10 per cent for the income tax. In this case, the Commissioner admittedly overstated "net income" by $556,700.54. Even if the entire credit for profits taxes were disallowed, the amount subject to the income tax would be reduced by $413,934.81 with respect to items concerning which the statutory provisions are mandatory and to no extent discretionary.

Congress has expressly provided definite methods of final determinations of income and profits taxes (a) through final agreements in writing made by a taxpayer and the Commissioner, with the approval of the Secretary, and (b) through compromises approved by the Secretary of the Treasury and the Attorney General. See *Botany Worsted Mills* v. *United States*, 278 U. S. 282. Neither method was followed in the present case. Petitioner argues, in effect, for still another method not provided by Congress, to wit, the mere application by a taxpayer for special assessment of profits taxes.[7] As this Court stated in the *Botany Worsted Mills* opinion, at page 288:

> "We think that Congress intended by the statute to prescribe the exclusive method by which tax cases could be compromised, requiring therefor the concurrence of

[7] It should be noted that the Commissioner does not consider the determination of income and capital binding on the Department, even though acquiesced in by the taxpayer. See *Austin Co.* v. *Commissioner*, 35 F. (2d) 910, and *Oak Worsted Mills* v. *United States*, 38 F. (2d) 699. In the present case, petitioner apparently does not claim that respondent acquiesced in the Commissioner's determination of net income. In any event, no such conclusion is justified by the record herein. Neither in the District Court nor in the Circuit Court of Appeals was any question of estoppel raised by petitioner herein. See Brief for the Respondent in Opposition, pp. 3-5. Accordingly, even if otherwise relevant, such an argument should not be considered in this case. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206; *Helvering* v. *Salvage*, 297 U. S. 106, 109.

> the Commissioner and the Secretary, and prescribing the formality with which as a matter of public concern, it should be attested in the files of the Commissioner's office; and did not intend to intrust the final settlement of such matters to the informal action of subordinate officials in the Bureau. When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode."

This is a case in which the Commissioner, as held by the courts, made an erroneous determination of net income—a determination involving no discretion. The petitioner's argument that this error must stand uncorrected for income tax purposes, merely because the taxpayer was entitled to and received treatment under Sections 327 and 328 as to its profits tax, imputes to Congress an unreasonable intention.

If in this case the Commissioner's overstatement of net income cannot be reviewed and corrected at the taxpayer's instance, it is unique in the system of corrective justice set up by the tax laws. As stated by the Court below (R. 39):

> "The Commissioner's discretion extends to the amount of this particular credit, and not to the right to claim deductions. A contrary holding would permit the Commissioner to enforce the statute or refuse to enforce it, according to his will, contrary to the intention of Congress."

CONCLUSION.

The decision below is correct and should be affirmed.

Respectfully submitted,

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APPENDIX.

Revenue Act of 1918, 40 Stat. 1057:

TITLE II—INCOME TAX.

Part III.—Corporations.

Tax on Corporations.

Sec. 230. (a) That, in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by section 4 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 236; and

(2) For each calendar year thereafter, 10 per centum of such excess amount.

Net Income Defined.

Sec. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

Credits Allowed.

Sec. 236. That for the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

(a) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in the gross income under section 233;

(b) The amount of any taxes imposed by Title III for the same taxable year: *Provided,* That in the case of a corporation which makes return for a fiscal year beginning in 1917 and ending in 1918, in computing the tax as provided

in subdivision (a) of section 205, the tax computed for the entire period under Title II of the Revenue Act of 1917 shall be credited against the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, and the tax computed for the entire period under Title III of this Act at the rates prescribed for the calendar year 1918 shall be credited against the net income computed for the entire period under this title; and

(c) In the case of a domestic corporation, $2,000.

Corporation Returns.

Sec. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228. When return is made under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

TITLE III—WAR-PROFITS AND EXCESS-PROFITS TAX.

Part IV.—Net Income.

Sec. 320. (a) That for the purpose of this title the net income of a corporation shall be ascertained and returned—

* * * * * * * * * * *

(3) For the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made

between April 6, 1917, and November 11, 1918, both dates inclusive.

Sec. 328. (a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a) containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936

No. 602

GALEN H. WELCH, *Former Collector of Internal Revenue for the Sixth Collection District of California, Petitioner,*

v.

OBISPO OIL COMPANY, *a Corporation*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMICUS CURIAE

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INDEX

PAGE

PETITION FOR LEAVE TO FILE BRIEF AMICUS CURIAE 1

BRIEF OF AMICUS CURIAE 2

Introduction 2

Brief of Argument 3

Argument 3

I. Special assessment has often been thrust upon a taxpayer without his request, without any agreement on his part as to the net income, and over his protest 3

II. The statute does not permit the special assessment section to be used to increase the tax beyond that imposed at the statutory rates 9

III. The position of the Collector is contrary to precedent, is unjust and is unnecessary 10

Conclusion 12

TABLE OF CASES

Austin Co. v. *Commissioner*, 35 Fed. (2d) 910 9

Botany Worsted Mills v. *United States*, 278 U. S. 282 4

Brownsville Bridge Co. v. *Commissioner*, 1 B. T. A. 320 10

Heiner v. *Diamond Alkali Co.*, 288 U. S. 502 ..... 2, 11, 12

McGrath Co. v. *Commissioner*, 10 B. T. A. 177 6

Oak Worsted Mills v. *United States*, 38 Fed. (2d) 699 9

Sumpter Valley Railway Co. v. *Commissioner*, 10 B. T. A. 1325 ..... 7, 10

United States v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189 ..... 2, 8, 9, 11

United Profit Sharing Corp v. *United States*, 66 Ct. Cl. 171 ..... 7, 10

Williamsport Wire Rope Co. v. *United States*, 277 U. S. 551 ..... 2, 11, 12

PAGE

A. R. R. 19, 2 Cumulative Bulletin 299 5
A. R. R. 70, 2 Cumulative Bulletin 287 4
A. R. R. 332, 3 Cumulative Bulletin 362 5
A. R. R. 459, 4 Cumulative Bulletin 399 5
A. R. R. 538, 5 Cumulative Bulletin 301 5
Sol. Op., III-1 Cumulative Bulletin 418 10

Revenue Act of 1917, Section 210 4
Revenue Act of 1918, Section 302 9

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PETITION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The undersigned respectfully petition this Court for leave to file the subjoined brief as a friend of the Court.

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BRIEF OF AMICUS CURIAE

INTRODUCTION

It is an undisputed principle of the law that the courts have jurisdiction in the proper case to recompute the tax liability of a taxpayer. In *Williamsport Wire Rope Co.* v. *United States*, 277 U. S. 551, and *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, this Court held that the courts might not review the exercise of an administrative discretion by the Commissioner of Internal Revenue. The soundness of those decisions is not questioned.

It will be the purpose of this brief, however, to point out that those decisions should not be extended to deprive the courts of jurisdiction to compute the tax under statutory provisions which involve no exercise of administrative discretion.

In *Heiner* v. *Diamond Alkali Co.*, *supra*, this Court said:

> "The respondent's tax could only be computed in accordance with Section 301 or under Section 328. The former prescribes the elements to be considered and *error in the computation remains subject to judicial correction.*"

We conceive the instant case to be an attack upon that statement and an attempt to reverse the decision of this Court in *United States* v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189. In that case the tax had been computed by the Commissioner under the special assessment provision. This Court, however, found no difficulty in determining the tax under the statutory provisions and affirming the judgment of the lower court for the recovery of the difference between the tax computed by the Commissioner under the special assessment rates and the tax at the statutory rates upon the revised income determined by the court.

It would seem a matter of course that while the courts may not grant special assessment or recompute the tax payable under the special assessment provision, they may determine the tax liability under those provisions of the statute which involve no discretion and, if the tax has been overpaid, give judgment for the overpayment.

BRIEF OF ARGUMENT

Special assessment has often been thrust upon a taxpayer without his request, without any agreement on his part as to the net income, and over his protest. The statute does not permit the special assessment section to be used to increase the tax beyond that imposed at the statutory rates. The position of the Collector is contrary to precedent, is unjust and is unnecessary. The Commissioner of Internal Revenue may not deprive the courts of jurisdiction to compute tax under the plain provisions of the statute which involve no exercise of administrative discretion by insisting upon determining the tax under the special assessment provisions. To so hold would place the taxpayer in the uncontrolled discretion of the Commissioner. It would permit a relief provision to be used to impose taxes in excess of those imposed by Congress and leave the taxpayer with no recourse to the courts.

ARGUMENT

I. Special assessment has often been thrust upon a taxpayer without his request, without any agreement on his part as to the net income, and over his protest.

It seems to be taken for granted in some of the decisions upon which the Collector relies in his brief that special assessment is granted only when the taxpayer and the Commissioner are agreed upon the factors to be used. Assum-

ing this as a fact, the decisions proceed by way of semi-estoppel[1] to reach the conclusion, not that the taxpayer may not recover in that particular case, but to hold that the granting of special assessment deprives the courts of any jurisdiction to entertain a suit to determine the tax under statutory rates involving the exercise of no administrative discretion. The history of the administration of this section contradicts any thought that the taxpayer was required to agree to the correctness of the determination of its income and make a request for special assessment before the tax was computed under the special assessment sections. Perhaps this should have been the practice, but it was not.

In a ruling made by the Committee on Appeals and Review in the office of the Commissioner of Internal Revenue in 1920,[2] it appeared that the taxpayer corporation claimed the right to have its invested capital determined by including therein the value of a certain patent and, presumably, its net income computed by allowing a deduction for the amortization or exhaustion of the patent value. The Committee stated that the value of the patent "cannot be satisfactorily determined". The opinion concludes:

> "The Committee is therefore of the opinion that the action of the Income Tax Unit in assessing the tax under the provisions of Section 210[3] was proper and works no injustice upon the taxpayer. For the same reason that Section 210 was applied under the 1917 Act, it is recommended that the company be assessed for 1918 and subsequent years under the provisions of Sections 327 and 328 of the Revenue Act of 1918."

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[1] But see *Botany Worsted Mills* v. *United States*, 278 U. S. 282, which outlines the only basis on which a binding agreement as to tax liability may be reached.

[2] A. R. R. 70, 2 Cumulative Bulletin 287.

[3] Section 210 of the Revenue Act of 1917 was the special assessment provision of that Act.

In A. R. R. 19, 2 Cumulative Bulletin 299 (1920), the Committee found difficulty in arriving at the facts, whereupon the Committee ruled:

> "The Committee is of the opinion that the facts, so far as they are known or asserted by the taxpayer, construed in the light of the regulations above quoted, clearly exclude the taxpayer from whatever benefit might be derived from the application of Section 209 of the Revenue Act of 1917, and therefore the Committee recommends that the appeal of the taxpayer for consideration under that section be denied and that the action of the Income Tax Unit in assessing tax under Section 210 of the above Act be approved and confirmed."

In A. R. R. 332, 3 Cumulative Bulletin 362 (1920), the following appears:

> "The taxpayer submits that the assessment under Section 210 imposes too high a tax, and that in lieu thereof the tax should be based on certain other methods of determining invested capital, which it does not seem necessary to now refer to in detail. • • • The Committee recommends that action of the Income Tax Unit in assessing the tax under Section 210 of the Act be sustained."

In A. R. R. 459, 4 Cumulative Bulletin 399, the following appears:

> "The Committee has had under consideration the appeal of the M Company, a corporation, from the action of the Income Tax Unit in assessing taxes for the year 1917 under Section 210 instead of under Section 207 of the Revenue Act of 1917. • • • The Committee accordingly recommends that the action of the Income Tax Unit, in disposing of this case under Section 210 of the Revenue Act of 1917, be sustained."

In A. R. R. 538, 5 Cumulative Bulletin 301, the following appears:

"The Committee has had under consideration the appeal of the M Company, formerly the N Company, from the action of the Income Tax Unit in computing the amount of war-profits credit to be allowed the corporation for the year 1918 under the provisions of Section 311(a) of the Revenue Act of 1918 and including in the closing inventory for that year the amount of fruit on hand in warehouses ready for sale. * * * In view of the foregoing, the Committee recommends that the M Company, formerly the N Company, be granted the benefit of assessment of excess-profits and war-profits taxes for the year 1918 under the provisions of Section 327 and 328 of the Revenue Act of 1918; that in the preparation of a comparative data sheet particular care be used to select only such comparatives as are fair both to the Government and to the taxpayer; and that the Unit be sustained in restoring to the closing inventory for that year the fruit on hand in warehouses and in transit to market, but not marketed and sold as of December 31, 1918."

While the earlier citations were under the Revenue Act of 1917, this decision of the Committee on Appeals and Review makes it clear that under the 1918 Act the Commissioner continued to compute taxes under the special assessment sections without first agreeing with the taxpayer upon the amount of its net income subject to the tax and, indeed, without any request for special assessment from the taxpayer.

Counsel has made an examination of Volume 10 of the reports of the United States Board of Tax Appeals. This volume covers the decisions rendered in two months of the year 1928 and was selected because it was in this period that the claim of the Obispo Oil Company was rejected by the Commissioner.

In *William McGrath Co.* v. *Commissioner*, 10 B. T. A. 177, it appeared that the Commissioner had computed the profits

tax for 1918 under the special assessment provision. The taxpayer there was contending that it had a right to have its tax computed at the statutory rates, while the Commissioner was contending that the invested capital could not be ascertained and that the Commissioner properly computed the tax under the special assessment provisions. The Board of Tax Appeals, however, found that the invested capital could be ascertained and directed the computation of the tax at the statutory rates.

Sumpter Valley Railway Co. v. *Commissioner*, 10 B. T. A. 1325, was a similar case. There the Board said:

> "Sections 327 and 328 have been held to be relief sections, and they cannot be used to impose upon a taxpayer a greater tax than he would have to pay under Section 326."

These are merely two examples from one volume of the Board of Tax Appeals Reports cited to establish the fact that special assessment was not something granted only at the request of the taxpayer, but was imposed by the Commissioner without request and over the protest of the taxpayer. Without doubt, an examination of the 34 volumes of those Reports would disclose many other such cases.

We find the same situation in some of the reported decisions of the courts. In *United Profit-Sharing Corp.* v. *United States*, 66 Ct. Cl. 171, it appears from the opinion of the court that in the years 1914, 1915 and 1916 the plaintiff made large expenditures which it charged to expense account. In filing returns for the years 1919 and 1920, it claimed that such a treatment was in error; that such expenditures were in fact capital expenditures and should be amortized over a period of years, including the years 1919 and 1920; that the income for those years should be reduced by an aliquot portion as amortization or exhaus-

tion in those years, and that the invested capital should include the unamortized amount of such expenditures. The Commissioner had refused to permit the invested capital or the income to be computed on that basis and, on the contrary, had determined that the tax should be computed under the special assessment provisions. The Court of Claims held that the contentions of the plaintiff were correct; that its income and invested capital should be adjusted accordingly and its tax computed under the statutory provisions.

In *United States* v. *Supplee-Biddle Hardware Co., supra,* a somewhat similar situation was presented to this Court. The Commissioner had held that the proceeds of certain life insurance policies should be included in computing the income of the taxpayer. Under this ruling the taxpayer was forced to pay a tax of $84,737.95. The Commissioner reduced this amount by $29,584.06 by computing tax under the special assessment provisions. There remained, however, the sum of $55,153.89 which was paid under protest. This Court proceeded to determine the issue upon its merits. It held that the proceeds of life insurance paid to a corporation were not taxable income under the provisions of the Revenue Act; that the Commissioner had erroneously included such amount, and that the taxpayer was entitled to recover.

We believe these cases conclusively establish that the Commissioner of Internal Revenue frequently applied the special assessment provisions of the Revenue Act without any agreement on the part of the taxpayer as to the amount of its income or invested capital, and at times when the amount of income and invested capital was in dispute. They also make it clear that the courts in the past have not hesitated to determine the tax at the rates prescribed by Con-

gress and grant refunds where excessive tax was assessed under the special assessment provisions.

There is another line of decisions which indicates that the exercise of the Commissioner's discretion under the special assessment sections lacks any finality.

In *Oak Worsted Mills* v. *United States*, 38 Fed. (2d) 699, it appeared that the Commissioner had determined the profits tax under the special assessment provisions. Subsequently he reopened his determination and computed and collected a greater tax. The court held that the Commissioner might reopen his determination at any time within the statute of limitations without regard to the existence of fraud.

In *Austin Co.* v. *Commissioner of Internal Revenue*, 35 Fed. (2d) 910, the Circuit Court for the Sixth Circuit had before it a similar case and reached the same decision.

II. The statute does not permit the special assessment section to be used to increase the tax beyond that imposed at the statutory rates.

Congress provided the rates at which taxes should be computed. It then imposed certain limitations on those taxes[1] and also provided that in certain cases the Commissioner should compute taxes by comparison with representative corporations. The history of these sections discloses that they were intended to extend relief to the taxpayers, and clearly shows that they were not intended for the purpose of increasing the taxes beyond those imposed by Congress at the statutory rates.

Perhaps it would be sufficient to cite the decision of this Court in *United States* v. *Supplee-Biddle Hardware Company, supra*, in which this Court permitted the taxpayer to recover the difference between the tax assessed and collected under the special assessment provisions and the tax properly computed at the statutory rates, or the decision

[1] Section 302, Revenue Act of 1918.

of the Court of Claims in *United Profit-Sharing Corporation* v. *United States, supra.* Counsel, however, would refer this Court to certain other sources. In the opinion of the Solicitor of Internal Revenue, No. 158, published in III-1 Cumulative Bulletin 418 (1924), the legislative history is considered at very considerable length, and the opinion states:

> "On the contrary, they were constantly referred to as 'relief measures' and are so characterized in Law Opinion 1109."

The Committee on Appeals and Review of the Treasury Department in 3 Cumulative Bulletin 360 (1920) said:

> "This office, therefore, concludes that special assessment is not required by either the Revenue Act of 1917 or 1918 when the tax computed upon the basis of the known invested capital is less than that computed under special assessment."

To the same effect are the decisions of the Board of Tax Appeals in *Brownsville Bridge Co.* v. *Commissioner*, 1 B. T. A. 320, and *Sumpter Valley Railway Co.* v. *Commissioner, supra.*

When the legislative history so clearly discloses that the special assessment provisions were intended for the relief of taxpayers, it is submitted that neither the Commissioner nor the courts should use them as a means to deprive the courts of jurisdiction to compute the amount of tax which is due under the rates imposed by the law. An instrument of relief should not be used as an instrument of oppression.

III. The position of the Collector is contrary to precedent, is unjust and is unnecessary.

It has been shown that special assessment was often thrust upon the taxpayer when the Commissioner was un-

able to agree with the contentions of the taxpayer with respect to invested capital, or with respect to taxable income. The decisions of the courts demonstrate that the Commissioner is frequently wrong in his determinations. Is there anything in the law which prohibits the courts from taking jurisdiction to correct those errors? In the *Supplee-Biddle Hardware Company* case we have a practical application of the question. The Commissioner insisted that certain amounts should be included in taxable income. The taxpayer resisted that determination. The Commissioner then computed the tax under special assessment. The contention of the appellant is, in effect, that under such circumstances no court could inquire into the correctness of the determination of the amount of the income, despite the fact that this Court found that the action of the Commissioner resulted in an overpayment of the tax by $55,153.86. The Court will recognize that if the contention of the appellant is sound, the taxpayer is entirely at the mercy of the Commissioner. All that the Commissioner need do is to determine that the tax should be computed under special assessment; thereafter the taxpayer will have no recourse to the courts. If the contention of the appellant is correct, this Court had no authority in the *Supplee-Biddle Hardware Company* case to inquire into the determination of the income or of the tax and the overpayment made by the taxpayer could not have been refunded to it.

It seems to us ridiculous to contend that the decisions of this Court in *Williamsport Wire Rope Company* and *Diamond Alkali Company, supra,* go to any such extremes. Those cases decide that the courts will not grant special assessment where the Commissioner denies it, and that the courts will not compute or recompute the tax due under the special assessment sections. Certainly they do not stand for the proposition that the courts may not determine the

tax which is due under the rates prescribed by Congress in the law.

In the instant case the law prescribes an income tax at the rate of ten per cent upon the statutory income. The elements which go into the computation of statutory income are carefully laid down in the statute, and as the court stated in *Heiner* v. *Diamond Alkali Company, supra,* are "subject to judicial correction."

CONCLUSION

It is respectfully submitted that the special assessment provisions of the Revenue Act were intended for the purpose of relieving the taxpayers and not as an excuse or trap for denying them the right to a proper computation of taxes, either in the Bureau of Internal Revenue or in the courts. It is further submitted that until very recently no contention had been made in the Bureau of Internal Revenue or in the courts that the granting of special assessment deprived the courts of jurisdiction to determine the proper tax at the statutory rates. It is further submitted that there is nothing in the decisions of this Court in *Williamsport Wire Rope Company, Heiner* v. *Diamond Alkali Company,* or in any other case, which justifies any conclusion that the courts may be ousted of their jurisdiction to determine the tax liability of a taxpayer at the rates prescribed by statute merely because the Commissioner of Internal Revenue sees fit to incorrectly determine the income of the taxpayer or the invested capital of the taxpayer and, on such erroneous determination, to compute a tax under the special assessment provisions of the law. It is part of the system for the collection of our taxes that the courts should review the determination of the tax liability and, while the courts will not review the determination of the tax under the special assessment provisions,

those provisions should not be used as a means of ousting the courts from jurisdiction to compute a tax under the plain provisions of the Revenue Act which are susceptible of judicial application.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 602.—October Term, 1936.

Galen H. Welch, Former Collector of Internal Revenue, etc., Petitioner, *vs.* Obispo Oil Co. } On Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[April 26, 1937.]

Mr. Justice Brandeis delivered the opinion of the Court.

The Revenue Act of 1918, c. 18, 40 Stat. 1057, laid upon corporations, in addition to the income tax, a war profits and excess profits tax at very high rates. Because the profits tax might prove unduly burdensome, Congress provided by Sections 327 and 328 for a special assessment of the profits tax by the Commissioner of Internal Revenue under certain circumstances. The question for decision in this case is whether, when a special assessment has been made of the profits tax, a court may entertain an action for refund of an amount paid on the accompanying income tax on the ground that the income was erroneously determined.

Obispo Oil Company brought, in the federal court for southern California, this action to recover an amount alleged to have been illegally exacted as income tax for the year 1920. Upon final assessment, the Commissioner had assessed its net income for that year at $1,476,330.52. Under Section 236 (b), it was necessary to deduct the profits tax and other amounts from the net income in order to determine the amount of the taxable net income. Because the net income of that year included large funds theretofore long in litigation, the Commissioner made a special assessment under Section 327 (d) to determine the profits tax.[1] Where a special assessment is made, Section 328 commands that "the tax shall be the amount which bears the same ratio to the net income of the taxpayer . . . for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income . . . for such year." The Commissioner fixed that ratio as 9.67 per cent; and,

[1] The amended complaint alleged that Sections 327 and 328 were applied "due to the abnormality resulting from the inclusion in plaintiff's income for that year [1920] of said impounded funds."

applying it to the Obispo Company's net income of $1,476,330.52, computed the profits tax at $142,765.73. When this and other allowable sums were deducted, the taxable net income was found to be $1,245,430.63.

The statutory tax rate on net income being 10 per cent., the income tax was determined to be $124,543.06. The Company paid the income tax so assessed; filed then a claim for refund thereof, setting up several grounds of recovery; and, the refund being refused, brought this suit against the Collector of Internal Revenue for the Sixth Collection District of California for alleged overpayment. The amended complaint alleged that the sum had been "illegally exacted from the plaintiff on account of additional income and profits taxes for the year 1920." In a trial held in 1931, the District Court held that the company was entitled to recover the full amount claimed. 48 F. (2d) 872. The Collector appealed to the United States Circuit Court of Appeals; but before the appeal was determined there, the case was, upon agreement of the parties, referred back to the District Court for correction, to accord with our decision in *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, which had meanwhile been rendered. Then the Collector moved in the District Court for judgment, claiming that the Company was not entitled to recover any part of the sum sued for; and, specifically, that the court had "no jurisdiction of the subject matter of this action, the tax sought to be recovered having been assessed under the special assessment provisions of Sections 327 and 328 of the Revenue Acts of 1918 and 1921."

The District Court overruled the Collector's motion to dismiss; ruled that the net income as determined by the Commissioner was excessive in the net amount of $40,102.44; and entered judgment for the Company in the sum of $4,010.24 with interest and costs. The Company appealed to the Circuit Court of Appeals, claiming chiefly that the 1920 net income should have been reduced by an additional depletion allowance of $516,598.10. The Collector filed a cross-appeal, claiming, among other things, that the District Court was without jurisdiction over the subject matter of the action, "the tax sought to be recovered having been determined and assessed by the Commissioner . . . under the special assessment provisions of Sections 327 and 328 of the Revenue Acts of 1918 and 1921." The Circuit Court of Appeals affirmed the District Court in holding that it had jurisdiction of the subject matter; but reversed

the judgment on the ground that the assessment had overstated the net income by the net amount of $556,700.54, so that there should have been deducted the sum of $516,598.10 for depletion, in addition to the sum found by the District Court. 85 F. (2d) 860. Certiorari was granted upon petition of the Collector (299 U. S. —) because of the practical importance of the question of jurisdiction presented.[2]

The Commissioner's action in applying or rejecting the procedure of Sections 327 and 328, and his computation of the profits tax thereunder and of the regular income tax are reviewable by the Board of Tax Appeals. When no special assessment has been made of the profits tax, an action will lie to recover an amount erroneously exacted either for income or for profits taxes. But no court has power to review the grant or denial of a special assessment or the correctness of the computation made thereon. *Williamsport Wire Rope Co.* v. *United States*, 277 U. S. 551; *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502. The Company concedes that the amount of the profits taxes, being the subject of a special assessment under Sections 327 and 328, could not be reviewed by the court; but it insists that recovery may be had of the sum alleged to have been erroneously exacted for income tax.

In *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502, 503, where a special assessment had been made of profits taxes under Sections 327 and 328, the taxpayer sued to recover a part of the profits tax, alleging error in the determination of the net income on which it was based. The Circuit Court of Appeals allowed recovery (60 F. (2d) 505, 513, 514). We reversed its judgment, holding that the court may not, in an action for a refund of profits tax, recalculate the taxpayer's net income and recompute the profits tax by applying to the corrected net income the ratio fixed by the Commissioner for the computation of the tax. We did not pass upon the question whether the same rule should be applied if the taxpayer seeks a refund of the income tax because of an alleged error in the computation of the net income. But the reasoning of the opinion leads to that conclusion.

The Company insists that, as it would, in view of the large deductions allowed by the Court of Appeals, be entitled to a sub-

[2] The question was present in United States v. Supplee-Biddle Hardware Co., 265 U. S. 189, and in Heiner v. Diamond Alkali Co., 288 U. S. 502, but was not submitted to the Court for decision.

stantial refund even if it were denied the deduction of the wh of the profits tax from the net income, Congress could not have tended that the deduction provision should deprive the courts jurisdiction to correct errors in determining the amount of t income from which the income tax is computed; that Congress tended to benefit the taxpayer when it directed that before co puting the 10 per cent. income tax the net income found should reduced by deducting the profits tax therefrom; and that, the fore, it is unreasonable to adopt a construction of the law und which the allowance of the profits tax credit would be consider as so essential an element in the computation of the tax that t taxpayer would be deprived of all other adjustments in the eve there is uncertainty as to the particular items.

By the statute the amount of the income tax payable is d pendent upon the amount of the profits tax; and the amount the profits tax is dependent upon the amount of the incom In order to determine the corporate income tax payable at th statutory rate of 10 per cent., of the taxable net income, the must first be deducted from the net income the amount of th profits tax. Sec. 236 (b). Thus, to compute the income tax in th case at bar, it was necessary first to deduct from the net incom ascertained as being $1,476,330.52, the profits tax which by apply ing, under Section 328 (a), the ratio of 9.67 per cent. to the ne income, was determined to be $142,765.73.

A change in the amount of net income to which the rate wa applied would, of course, produce a change in the amount of th profits tax. Indeed, a different computation of net income might have made it proper to compare the taxpayer with a wholly dif ferent group of representative corporations, and hence might have resulted in the determination of a different rate for the profits tax. And moreover, the Commissioner, having authority, in his discre tion, to determine whether there should be a special assessment, might have refused to make one. It is no less true in the present situation than in *Heiner* v. *Diamond Alkali Co., supra,* 506, that the taxpayer's true net income is an essential factor in the deter mination of his liability under Sections 327 and 328; and it follows that the making of the special assessment precludes review by a court of the income tax determined.

Reversed.